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In the Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY, APPELLANT

v.

THE IOWA DEPARTMENT OF REVENUE, APPELLEE

On Appeal from the Supreme Court of Iowa

JURISDICTIONAL STATEMENT

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QUESTION PRESENTED

Whether the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331 *et seq.*, prohibits the states from taxing income earned from the extraction of oil and gas from the outer Continental Shelf.

PARTIES TO THE PROCEEDING AND RULE 28.1 STATEMENT

All of the parties to the appeal of Shell Oil Company in the Supreme Court of Iowa are listed in the caption to this Jurisdictional Statement. Kelly-Springfield Tire Co. was a party to a separate appeal that was consolidated with the Shell appeal in the Iowa Supreme Court because of an issue, entirely unrelated to the question presented in this Court, that was common to the two appeals below.

Shell Oil Company's parent companies, subsidiaries (excluding wholly-owned subsidiaries) and affiliates are listed in Appendix G, *infra*, 97a-103a.

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Supreme Court of Iowa (App., *infra*, 1a-14a) is reported at 414 N.W.2d 113. The opinion of the District Court of Polk County (App., *infra*, 15a-35a) is not reported.

JURISDICTION

The judgment of the Supreme Court of Iowa was entered on October 21, 1987 (App., *infra*, 1a). A notice of appeal to this Court (App., *infra*, 92a-93a) was filed on November 23, 1987. The jurisdiction of the Court over this appeal is invoked under 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case presents the question whether the Iowa corporate income tax code, as applied to appellant Shell Oil Company, is invalid under the Supremacy Clause of the

United States Constitution (Art. VI, cl. 2) to the extent that it conflicts with the provisions of the Outer Continental Shelf Lands Act ("OCSLA"), 43 U.S.C. §§ 1331 *et seq.* The relevant provisions of the OCSLA and the Iowa corporate income tax code are set forth in App., *infra*, 94a-96a.

STATEMENT

This case is a companion to *Shell Oil Co.* v. *Department of Revenue, State of Florida*, appeal pending, No. 86-1593 (filed Mar. 20, 1987). It presents the question whether the Outer Continental Shelf Lands Act ("OCSLA"), 43 U.S.C. §§ 1331 *et seq.*, prohibits states from taxing income earned from the extraction of oil and gas on the outer Continental Shelf ("OCS") pursuant to federal lease.[1] Contrary to the decision below, such taxation is invalid under the OCSLA and the Supremacy Clause because it is inconsistent with the exclusive jurisdiction of the federal government over the OCS, with the explicit language of the OCSLA that state taxation laws "shall not apply" to the OCS, and with the congressional policy of prohibiting state taxes of OCS production in order to enhance the federal government's revenues from lease payments and to promote development of the OCS.

A. The Outer Continental Shelf Lands Act

The outer Continental Shelf is defined as all submerged lands appertaining to the United States that are outside the area three geographical miles (three marine leagues in the case of Florida and Texas) from the coastline of the United States. See 43 U.S.C. §§ 1331(a) and 1301 (a)(2). The OCS lies off the shores of the continental

[1] The term "income earned" refers to the portion of income from the sale of OCS oil and gas that is attributable to the extraction of the resource on the OCS. In other words, it is the increment of income that represents the net value at the wellhead (*i.e.*, fair market value less related costs and expenses) of the OCS production.

United States, Alaska, and Hawaii, and is not located within any of the 50 states. App., *infra*, 18a-19a.

Beginning in the 1930s, a dispute developed between the federal government and the states over off-shore lands (both inside and outside the three-mile limit) and the natural resources they contain. In a series of decisions, this Court held that the states were "not the owner of the three-mile marginal belt along [the] coast, and that the Federal Government rather than [a] state has paramount rights in and power over that belt, an incident to which is full dominion over the resources of the soil under that water area, including oil." *United States* v. *California*, 332 U.S. 19, 38-39 (1947); see also *United States* v. *Louisiana*, 339 U.S. 699, 705 (1950) ("[i]f, as we held in California's Case, the three-mile belt is in the domain of the Nation rather than of separate States, if follows *a fortiori* that the ocean beyond that limit also is"); *United States* v. *Texas*, 339 U.S. 707 (1950).

In response to these rulings recognizing the paramount rights of the United States in such off-shore areas, Congress in 1953 enacted two statutes. First, in the Submerged Lands Act, 43 U.S.C. §§ 1301-1315, Congress relinquished to the states title to and ownership of the submerged lands and natural resources within the three-mile limit. By that Act "the United States, in effect, quitclaimed to [the states] whatever interest the Federal Government may have had in, and to, all lands and natural resources lying within three geographical miles seaward of the * * * coastline." *United States* v. *California*, 447 U.S. 1, 3 (1980); see also *Secretary of Interior* v. *California*, 464 U.S. 312, 315-316 (1984); *United States* v. *Louisiana*, 363 U.S. 1, 6-7 (1960).

Second, Congress adopted the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331-1356. The OSCLA declares that the outer Continental Shelf is "subject to [the]

jurisdiction [and] control [of the United States]" (43 U.S.C. § 1332(1)) and is "an area of exclusive Federal jurisdiction" (43 U.S.C. § 1333(a)(1)). Accordingly, the "Constitution and laws" of the United States were extended to the OCS (*ibid.*). Moreover, "to fill the substantial 'gaps' in the coverage of federal law, OSCLA borrows the 'applicable and not inconsistent' laws of the adjacent States as surrogate federal law." *Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. 473, 480 (1981); see 43 U.S.C. § 1333(a)(2)(A); *Rodrigue* v. *Aetna Casualty & Surety Co.*, 395 U.S. 352, 356-359 (1969). This Court has recognized that the OCSLA establishes "the exclusive jurisdiction and control of the Federal Government" over the OCS (*Gulf Offshore*, 453 U.S. at 479 n.7).

In addition to providing that the OCS is an area of exclusive federal jurisdiction, the OCSLA specifically addresses the issue of state taxation. Section 1333(a)(2)(A) provides that "State taxation laws shall not apply to the outer Continental Shelf." This prohibition is reinforced by Section 1333(a)(3), which directs that the OCSLA "shall never be interpreted as a basis" for a state to claim "any interest in or jurisdiction * * * over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom."

The OCSLA recognizes that "the outer Continental Shelf is a vital national resource reserve" that "should be made available for expeditious and orderly development" (43 U.S.C. § 1332(3)). In furtherance of that policy, the federal government has established a system of competitive bidding to lease OCS lands for the exploration, development, and production of crude oil, natural gas, and other minerals. See 43 U.S.C. §§ 1334, 1337. Although the Act authorizes several alternatives, a lessee generally pays the government a cash bonus when its bid is accepted, a fixed delay rental during the period prior to production, and a production royalty that

is normally one-sixth of the value of production as measured by the volume of production times the industry posted price at the wellhead. *Watt* v. *Energy Action Educational Foundation*, 454 U.S. 151, 153-154 (1981). Between 1954 and 1985, the federal government received some $52.7 billion in OCS lease bonus payments, $28.1 billion in royalties, and $0.7 billion in other revenues. U.S. Dep't of the Interior, *Federal Offshore Statistics: 1985*, Tables 2 & 16.

B. Shell's OCS Oil And Gas Activities

Appellant Shell Oil Company is a Delaware corporation with business operations in all 50 states and the District of Columbia. Shell is engaged in the exploration for, and the development, production, transportation, purchasing, and marketing of, crude oil and natural gas, and in the purchase, manufacture, and marketing of oil and chemical products. App., *infra*, 16a.[2]

Pursuant to leases obtained from the federal government through competitive bidding, Shell explores for and extracts crude oil and natural gas on the OCS. App., *infra*, 19a; Stip. ¶ 23. During the past decade, Shell has paid the government more than $2.2 billion in cash bonuses on Gulf of Mexico and Atlantic federal off-shore leases, $18 million in pre-production rentals, and $2.4 billion in royalties.

Shell controls the disposition of the crude oil and natural gas that it extracts from the OCS. Shell sells all of its gas production to third parties on the Shelf. See *Maryland* v. *Louisiana*, 451 U.S. 725, 730, 731 (1981) (most OCS gas is sold at the wellhead). In contrast, while Shell sells a small portion of its OCS oil on the

[2] The factual record in this case was stipulated by the parties, and the facts recited in the lower courts' opinions are based on that stipulation ("Stip."). The facts summarized in this Jurisdictional Statement relate to calendar years 1975-1980, the tax years in dispute below.

Shelf, most of its oil production is transferred internally between divisions of Shell on the OCS and is then brought to the mainland, where it is either sold to third parties or refined by Shell for subsequent sale. App., *infra*, 17a, 20a; Stip., ¶ 23.

The oil and gas extracted from the OCS has a determinable fair market value at the wellhead. The market value of the gas is the actual price at which it is sold to third parties on the Shelf, which is determined by contract in compliance with federal regulations. With respect to OCS oil, Shell determines fair market value based on the industry posted price on the OCS (*i.e.*, prior to transportation and processing); Shell uses that market value not only in its corporate accounting system maintained in the ordinary course of business, but also in computing royalty payments to the government pursuant to OCS leases, in establishing depletion allowances under the Internal Revenue Code, and in calculating the federal excise tax on windfall profits. The fair market value of OCS production, less related costs and expenses, represents the income earned from the extraction of oil and gas on the OCS. App., *infra*, 17a; Stip., ¶ 23. See note 1, *supra*.

C. Iowa's Apportioned Tax System

Shell's principal business in Iowa consists of marketing oil and chemical products that it has refined and manufactured. It is not possible to determine whether the products sold in Iowa were derived from OCS or non-OCS oil. App., *infra*, 17a-20a. Shell's operations constitute a "unitary business" substantially similar to that in *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980). App., *infra*, 18a. Because Shell is a unitary business, its corporate income tax in Iowa is determined under the State's apportionment methodology.

Formula apportionment is a recognized method for determining the portion of the aggregate income of a

multistate unitary business that is attributable to a given state and thus taxable by that state. "[N]et income from all sources [not allocated to a specific situs], whether within or without the State, includable in the tax base * * * becomes the apportionable base to which the formula is applied." J. Hellerstein, *State Taxation* ¶ 9.1 at 478 (1983). See, *e.g.*, *ASARCO, Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, 333-334 (1982); *Mobil Oil Corp.* v. *Vermont Comm'r of Taxes*, 445 U.S. 425, 437-439 (1980).

Section 422.33 of the Iowa Tax Code applies a one-factor apportionment formula based on sales inside and outside the State. See *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978). As described by the Iowa District Court (App., *infra*, 26a-27a):

> The formula for calculating that portion of a multistate corporation's income subject to Iowa income tax under the one factor formula is as follows:

$$\left(\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales}}\right) \times \left(\begin{matrix}\text{Federal Taxable Income} \\ \text{Adjusted Per Iowa Law}\end{matrix}\right) = \text{Iowa Income}$$

At issue in this case is the proper determination of the income base (*i.e.*, the adjusted "Federal Taxable Income" component above) to which the apportionment factor is to be applied to calculate Iowa income.[3] Shell submits that the OCSLA prohibits states from taxing the income earned from oil and gas that it extracted from the OCS and therefore that the net wellhead value of that produc-

[3] In contrast to Iowa, most other apportionment jurisdictions (including Florida) utilize some form of three-factor formula based on payroll, property, and sales. The difference between the one-factor and three-factor methodologies does not affect the question presented in this appeal: what is to be included in the income base that is subject to apportionment.

tion must be excluded from the income base that is apportionable among the states.[4]

D. The Proceedings Below

This appeal involves Shell's Iowa taxes for the years 1978-1980.[5] The Iowa Department of Revenue issued a Notice of Assessment to Shell based on the inclusion of Shell's OCS income in the apportionable tax base.[6]

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[4] In equation form, Shell contends that the apportionable income base is:

$$\left(\begin{array}{c}\text{Federal Taxable Income}\\ \text{Adjusted Per Iowa Law}\end{array}\right) - \left(\begin{array}{c}\text{Income Earned From}\\ \text{OCS Production}\end{array}\right) = \begin{array}{c}\text{Non-OCS}\\ \text{Taxable Income}\end{array}$$

Because, for consistency, the apportionment factor also would have to be adjusted for OCS sales, Shell's income taxable in Iowa would be (App., *infra*, 27a):

$$\left(\frac{\text{Iowa Gross Sales}}{\begin{array}{c}\text{Everywhere Gross Sales}\\ -\text{OCS Gross Sales}\end{array}}\right) \times \left(\begin{array}{c}\text{Non-OCS}\\ \text{Taxable Income}\end{array}\right) = \text{Iowa Income}$$

[5] In the courts below, Shell's OCS argument also encompassed the tax years 1975-1977, but the Iowa Supreme Court's decision on unrelated state-law grounds (App., *infra*, 2a-7a) has now resolved those earlier years in Shell's favor.

[6] The amounts in dispute due to the OCS issue were as follows:

	Income Apportioned To Iowa		Differences In Tax On Account Of OCS Issue	
Year	Department Method ($)	Shell Method ($)	Increase (Decrease) In Tax Per Assessment ($)	Increase (Decrease) In Tax Per Assessment (%)
1975	3,457,254	3,043,554	41,369	13.7%
1976	4,773,053	3,847,942	62,511	16.3%
1977	3,741,663	3,506,061	23,460	6.7%
1978	3,698,792	3,784,909	(8,612)	(2.3)%
1979	5,584,753	4,898,861	71,590	14.8%
1980	4,671,395	3,813,008	85,839	22.7%

See Shell's Opening Brief (at 5) and Reply Brief (at 14) in the Iowa Supreme Court (figures derived from Exh. 7, Iowa S.Ct. App. 182-187). As tax year 1978 illustrates, the exclusion of OCS income can result in *higher* taxes if OCS operations represent a loss rather than a gain.

After the Department of Revenue rejected Shell's administrative protest (App., *infra*, 36a-38a, 39a-91a), Shell sought judicial review in the Iowa District Court for Polk County. That court sustained the Department's inclusion of OCS income in the apportionable base, holding that the OCSLA does not prevent states "from indirectly taxing some portion of OCS activities pursuant to a constitutionally permissible apportionment scheme related to [the taxpayer's] sales in the taxing state" (*id.* at 31a).

The Iowa Supreme Court affirmed this ruling. App., *infra*, 7a-14a. Based on the legislative history of the OCSLA, the court below construed "the language restricting the application of state taxation laws to the OCS and denying to the state any interest in the natural resources or revenues from the seabed and subsoil of the OCS [to be] intended as a limitation on the authority of states adjacent to OCS lands to extend legislative jurisdiction to the OCS" (*id.* at 10a). Given this construction, the court held that the OCSLA does not bar Iowa's taxation of Shell's OCS income (*id.* at 11a):

> [Iowa's tax] is in no way dependent upon the exercise of legislative jurisdiction on OCS lands. Its taxing jurisdiction depends instead on the nexus of Shell's activities within this state. The inclusion of some OCS revenues in the apportionment formula is simply a method of obtaining an acceptable measure of the local nexus.

The Iowa Supreme Court made clear that the State could include in the tax base Shell's earnings from *all* OCS oil and gas, whether Shell's sales of those OCS products occurred on or off the Shelf. Discussing the related decision in *Shell Oil Co.* v. *Department of Revenue*, 496 So.2d 789 (Fla. 1986), appeal pending, No. 86-1593 (U.S. filed Mar. 20, 1987), which upheld the inclusion of

OCS income in the apportionment base, the court noted that the Florida case "had excluded from the[] apportionment formula that portion of Shell's gross revenues which were derived from sales made on OCS lands" (App., *infra*, 10a). In contrast, "[i]n the present case, Iowa has apparently included in its gross apportionment formula some revenues derived by Shell from the sale of natural gas at the platform on the OCS" (*ibid.*). Without further explanation, the court concluded that "[w]e do not believe, however, that this distinction warrants a result in the present case which differs from the one reached by the Florida court" (*ibid.*). Thus, under the decision below, every state is free to tax its apportioned share of all of Shell's ICS income, including income from sales to third parties that take place on the outer Continental Shelf itself.

THE QUESTION IS SUBSTANTIAL

This appeal presents the interrelated issues whether the OCSLA permits states to tax the income earned from oil and gas that the taxpayer extracts from the OCS pursuant to federal lease and (1) sells to third parties on the Shelf or (2) transports to the mainland for subsequent sale to third parties. The second issue is identical to that presented in Shell's pending appeal to this Court in *Shell Oil Co.* v. *Department of Revenue, State of Florida*, No. 86-1593 (filed Mar. 20, 1987). In the Florida case, the Solicitor General has filed an *amicus curiae* brief recommending that the Court grant review of the issue concerning OCS income from off-Shelf sales. Review of that issue is equally warranted here.

As to the issue regarding income from on-Shelf sales, the need for this Court's review is even more clearly indicated. The difference between the decisions of the Iowa and Florida Supreme Courts will be a source of confusion for state tax administrators and multistate corporations alike over the limits imposed by the OCSLA on state taxation of oil and gas sales that occur on the OCS.

Moreover, the Solicitor General's *amicus curiae* brief recognized that the OCSLA prohibits states from taxing OCS income from sales on the Shelf (U.S. Am. Br. 6, 16):

> [A]s Florida has properly conceded * * *[,] a State [may not], consistently with the Supremacy Clause, tax income earned by Shell from OCS oil or gas sales that are completed on the OCS itself.
>
> * * * * * *
>
> Florida has conceded, as it must, that Shell's sales of OCS oil to independent third parties, if completed on the OCS itself, are immune from state income taxation.

Indeed, with specific reference to the instant case then pending in the Iowa Supreme Court, the Solicitor General stated that a decision sustaining apportionment of OCS income from sales on the Shelf would be in "error," would be contrary to the interests of the federal government, and would be appropriate for this Court's review (*id.* at 16, 17 & n.12).

The question presented in this appeal, which is within the Court's mandatory jurisdiction, is of considerable public importance. More than 40 states and the District of Columbia use formula apportionment to tax the income of multistate unitary businesses. Both multistate taxpayers and the taxing authorities in these jurisdictions—only one of which (Kentucky) has excluded the total income derived from OCS oil and gas—will be directly affected by the Court's resolution of this case. As the Solicitor General has noted, tax issues concerning OCS oil and gas are of substantial significance "to oil companies and to the States, given the magnitude of the off-shore leasing program" (U.S. Am. Br. 17). Plenary review of Shell's appeal is plainly warranted.[7]

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[7] This case relates only to taxation of the income earned from the extraction of oil and gas on the OCS. See note 1, *supra*. States are free, of course, to tax the portion of a taxpayer's income that is attributable to the subsequent transporting, processing, and marketing of OCS production.

A. The OCSLA Prohibits States From Taxing The Income Earned From The Extraction Of Oil And Gas On The OCS

Unlike most state income tax cases that the Court has decided, this appeal does not involve a challenge to the validity of the apportionment formula used to prorate among the states the aggregate income of a multistate unitary business. Instead, this case presents the antecedent question of what may be included in the income base that is subject to apportionment. See *Mobil Oil Corp.* v. *Vermont Comm'r of Taxes*, 445 U.S. 425, 434-435 (1980).[8] Here, that question is answered by the OCSLA, which requires states to exclude OCS oil and gas income from apportioned taxation. Just as Congress has determined that other significant federal interests warrant granting an immunity from state income tax laws (see, *e.g.*, 31 U.S.C. § 3124(a) (states may not tax dividend and interest income derived from federal securities); 23 Iowa Code § 422.35(1)), so, too, Congress has concluded that state taxation of income derived from production on the outer Continental Shelf would frustrate its policies in that exclusively federal domain.

1. *The plain language of the OCSLA prohibits Iowa's tax on Shell's OCS oil and gas income*

Iowa's income tax indisputably imposes a levy on the income Shell earned from the extraction of oil and gas from the OCS pursuant to federal lease. That income, by virtue of its inclusion in Shell's apportionable income from sales of OCS oil and gas, is reflected in Iowa's pro rata share of income that is the basis for computing Shell's tax liability to the State. Iowa's taxation of Shell's OCS oil and gas income is prohibited by the plain language of the OCSLA.

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[8] Because Shell's contention is that states cannot tax OCS oil and gas income at all, the same question would be presented if Iowa were the only state in which Shell did business.

By its express terms, the OCSLA asserts the "jurisdiction" and "control" of the United States over the OCS (43 U.S.C. § 1332(1)) as a "vital national resource reserve" that "should be made available for expeditious * * * development" (43 U.S.C. § 1332(3)). Accordingly, in extending the Constitution and laws of the United States to the Shelf, the Act provides that the OCS is "an area of exclusive Federal jurisdiction" (43 U.S.C. § 1333 (a)(1)).

Under settled principles, states cannot impose a tax on private property or persons within an area of exclusive federal jurisdiction, absent the consent of Congress. Exclusive federal jurisdiction "is in essence complete sovereignty. That is, not only is the federal property immune from taxation because of the supremacy of the Federal Government, but state laws, not adopted directly or impliedly by the United States, are ineffective to tax or regulate other property or persons upon that enclave." *S.R.A.* v. *Minnesota*, 327 U.S. 558, 562-563 (1946). Thus, "[w]herever the United States has such jurisdiction the State would have no authority to lay the tax." *James* v. *Dravo Contracting Co.*, 302 U.S. 134, 140 (1937). In *Humble Pipe Line Co.* v. *Waggonner*, 376 U.S. 369 (1964), for example, the Court applied these principles to hold that the state could not tax a private party who had leased land in an exclusive federal enclave to develop oil and gas reserves. Similarly, in *Ramah Navajo School Bd.* v. *New Mexico Bureau of Revenue*, 458 U.S. 832 (1982), the Court held that the state could not impose a gross receipts tax on a non-Indian construction company engaged in building a school on an Indian reservation.

Given the explicit provision in Section 1333(a)(1) that the outer Continental Shelf is an area of exclusive federal jurisdiction, this analysis normally would be sufficient to prevent state taxation based on OCS activities. However, because 43 U.S.C. § 1333(a)(2)(A) incorpo-

rates certain state laws as surrogate federal law applicable to the OCS (see page 4, *supra*), Congress could not rest with the general preemptive implications of exclusive federal jurisdiction. Instead, it affirmatively exercised its plenary authority over federal property (see, *e.g.*, *Kleppe* v. *New Mexico*, 426 U.S. 529, 540-546 (1976)) to enact two additional provisions that confirm the invalidity of state taxation of income earned from the extraction of OCS oil and gas.

First, in language that is noteworthy for its clarity and directness, Congress declared: "State taxation laws shall not apply to the outer Continental Shelf" (43 U.S.C. § 1333(a)(2)(A)). It is hard to imagine simpler or more sweeping language to prohibit state taxation of the income attributable to the production of oil and gas on the Shelf.

Second, Congress provided that the OCSLA "shall never be interpreted" as a basis for a state to claim "any interest in or jurisdiction * * * over * * * the revenues" from the OCS (43 U.S.C. § 1333(a)(3)). This emphatic prohibition precludes Iowa from claiming "any interest" in Shell's apportioned "revenues" from OCS oil and gas.

Other provisions of the OCSLA confirm the view that state taxation of OCS activities is impermissible. For example, the Mineral Leasing Act, 30 U.S.C. § 189, expressly allows states "to levy and collect taxes upon * * * any lessee of the United States." See *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 631-632 (1981). However, Congress chose to make the Mineral Leasing Act inapplicable to the OCS by providing that "mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of [the OCSLA]" [43 U.S.C. § 1333(a)(1)).

Significantly, Congress also did not extend the Buck Act to the OCS. The Buck Act of 1940, 4 U.S.C. §§ 105-

110, constitutes congressional authorization for states to impose specified taxes on people or property in federal areas. See *United States* v. *Mississippi Tax Comm'n*, 421 U.S. 599, 603, 611 (1975). In particular, 4 U.S.C. § 106 provides that a state shall have "full jurisdiction and power to levy and collect" income taxes in any federal area within the state, and that "[n]o person shall be relieved from liability for any income tax levied by any State * * * by reason of his * * * receiving income from transactions occurring or services performed" in a federal area. However, because the Buck Act is restricted to federal areas "located within the exterior boundaries" of a state (4 U.S.C. § 110(e)), it is inapplicable to the OCS. The failure of the OCSLA to incorporate the Buck Act's specific authorization for state income taxes is telling evidence that reinforces the conclusion that states may not tax the income Shell earned from the extraction of OCS oil and gas.

2. The legislative history and policies of the OCSLA preclude Iowa's tax on Shell's OCS oil and gas income

Where, as here, the express provisions of a federal statute prohibit a state tax, it is unnecessary for courts to look behind the statute to consider the legislative history and congressional policies underlying the prohibition. See, *e.g.*, *Aloha Airlines* v. *Hawaii Director of Taxation*, 464 U.S. 7, 12 (1983). In any event, the history and purposes of the OCSLA further demonstrate that Iowa's tax on Shell's OCS oil and gas income is invalid.

The legislative history of the OCSLA is extensive, involving a number of separate bills introduced and debated over several Congresses. But for present purposes, one feature of this history stands out: the states made repeated attempts to obtain tax or lease revenues from the OCS, which Congress consistently rejected in order to preserve exclusive federal jurisdiction over, and exclusive federal revenues from, the OCS.

Numerous proposals were introduced in Congress to enable states to share directly or indirectly in the wealth of the OCS. These included proposals: to extend state police powers, including the taxing power, to the OCS;[9] to permit the states to impose severance or production taxes but to exclude all other forms of taxation;[10] to apply the Mineral Leasing Act to the OCS, which would have allowed the states to levy taxes (see page 14, *supra*);[11] to provide states with a portion of the royalties paid to the United States for OCS leases;[12] to establish a joint congressional committee to determine federal reimbursement to the states for services provided to OCS lessees and their employees;[13] and to use the proceeds of OCS leases for grants to public education, which would have redounded largely to the financial benefit of the states.[14] In the end, however, all of these proposals were defeated, and both the House bill (whose language was incorporated in 43 U.S.C. § 1333(a)(2)(A)) and the Senate bill (whose language was incorporated in 43 U.S.C. § 1333(a)(3)) were in agreement that the states were not entitled to any part of the tax or lease revenues from the OCS.[15]

The power of the states to tax OCS activities was repeatedly discussed and emphatically denied by Congress. For example, the Senate Report on the OCSLA explained

[9] See H.R. Rep. No. 695, 82d Cong., 1st Sess. 7, 13 (1951); *Outer Continental Shelf: Hearings on S. 1901 Before the Senate Comm. on Interior and Insular Affairs*, 83d Cong., 1st Sess. 471 (1953).

[10] See H.R. Rep. No. 215, 83d Cong., 1st Sess. 7-8 (1953).

[11] See S. Rep. No. 411, 83d Cong., 1st Sess. 23, 37 (1953); 99 Cong. Rec. 6966 (1953) (remarks of Sen. Cordon).

[12] See S. Rep. No. 411, at 3.

[13] See 99 Cong. Rec. 7251-7255 (1953).

[14] See S. Rep. No. 411, at 3.

[15] See H.R. Conf. Rep. No. 1031, 83d Cong., 1st Sess. 12 (1953).

that state taxation laws "necessarily are excluded" from the OCS, a proposition that Section 1333(a)(3) made "plain" in "precise unequivocal language."[16] Similarly, Representative Keating, in introducing the amendment to the House bill that eventually was enacted as the state tax prohibition in Section 1333(a)(2)(A), referred to the position of the Secretary of the Interior that states "should have no taxing power whatsoever on the outer Continental Shelf" and "should be given nothing from the resources."[17] In the words of the Conference Report, "State taxation laws are specifically banned."[18]

Congress well understood the absolute and sweeping nature of the prohibition on state taxes. For example, Representative Boggs, in a colloquy with Representative Keating, explained that the Keating amendment "strikes out any participation by the States in the taxing of these resources."[19] Likewise, Representative Brooks observed that OCS lessees would be "immune to State and local laws as far as taxes are concerned."[20] And Representative Graham noted that "taxing powers" were "completely denied to the States."[21] The Senate debates equally reflected that "the sole jurisdiction, control, and right to tax *in any form* is in the United States"[22] and that states would not be permitted to "tax[] private lessees engaged in operations on the outer shelf."[23]

Senator Long of Louisiana, whose State was intensely interested in the taxing and revenue provisions in the

[16] See S. Rep. No. 411, at 3, 23, 11.

[17] 99 Cong. Rec. 2572 (1953).

[18] H.R. Conf. Rep. No. 1031, at 12.

[19] 99 Cong. Rec. 2572 (1953).

[20] *Id.* at 2577.

[21] *Id.* at 4883.

[22] *Id.* at 7234 (remarks of Sen. Cordon) (emphasis added).

[23] *Id.* at 7259 (remarks of Sen. Daniel).

OCSLA, correctly perceived the restrictions on state taxing power that are relevant in this case. In particular, noting in the Senate Report that the Act "den[ied] the States any power of taxation," [24] Senator Long recognized that OCS lessees would be "subject neither to the State's severance tax, property tax, *nor the tax on corporate profits.*" [25] He later reiterated these points on the floor, adding that OCS lessees "are beyond the reach of the State." [26] At no time in the legislative debates on the OCSLA did anyone express disagreement with Senator Long or correct his understanding of the Act.

Congress's determination to prohibit state taxation of OCS oil and gas reflected two basic considerations. First, the OCS was regarded as "peculiarly a matter" of federal concern [27] and "uniquely an area of exclusive Federal jurisdiction and control." [28] OCS lands "are wholly outside the boundary of any State" [29] and—as this Court recognized in its decisions in the *California*, *Louisiana*, and *Texas* cases—the "States never had title to this territory." [30] Thus, "'[t]he situation is not comparable to that of federally owned areas within a State * * *.'" [31] Rather, the OCSLA was considered to be "unique legislation" that recognized "that the assets obtained from * * * [the OCS] shall be regarded as purely and wholly Federal assets, and that the profits obtained therefrom shall be

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[24] S. Rep. No. 411, at 65 (minority report).

[25] *Id.* at 67 (emphasis added).

[26] 99 Cong. Rec. 7260-7261 (1953).

[27] S. Rep. No. 411, at 6.

[28] 99 Cong. Rec. 6963 (1953) (remarks of Sen. Cordon).

[29] *Id.* at 10472 (remarks of Sen. Cordon).

[30] *Id.* at 2499 (remarks of Rep. Celler).

[31] S. Rep. No. 411, at 6. See also 99 Cong. Rec. 7254 (1953) (remarks of Sen. Cordon).

regarded as profits belonging to the Federal Government and as revenue of the Federal Government." [32]

Second, Congress was concerned that state taxation would both diminish federal revenues from OCS leases and impair the national interest in the prompt development of OCS resources. Representative Keating explained this concern in connection with his amendment to prohibit state taxes, pointing out that such levies on OCS oil and gas would decrease the net value of the leases and thus reduce the amounts lessees would be willing to pay to the government:

> My concern is for the taxpayers of the United States, for in truth it would be their money we would be generous with if we leave the present wording in the bill.
>
> The tax imposed by the adjacent States would fall, at least indirectly, on the United States, the landlord of this area, since the terms of any lease entered into would have to be fixed in order to permit the lessees a fair return and a proper incentive to develop the area.[33]

As this Court recognized in *Maryland* v. *Louisiana*, 451 U.S. 725, 752-753 n.26 (1981), "[t]he proper fee or charge for drilling * * * on the OCS is a determination which is *solely* within the province of the Federal Government," and "[p]ermitting the States to exercise such power [of taxation] would *adversely affect the price which the Government could command from private developers in their bid price*" (second emphasis added).[34]

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[32] 99 Cong. Rec. 7252 (1953) (remarks of Sen. Holland).

[33] *Id.* at 2571. Other members of Congress noted that state taxes would "bring about an increased cost in the price of oil and gas" to consumers throughout the country (*id.* at 2527 (remarks of Rep. Madden)), including the United States in its purchases of oil for the national defense (*id.* at 2535 (remarks of Rep. Yates)).

[34] The importance of the government's financial interest in OCS leases was reinforced in the 1978 amendments to the OCSLA. As

In the same way, state taxation of OCS oil and gas income would, as Representative Keating noted in the foregoing remarks, impede a "fair return" to lessees and interfere with the "proper incentive" for them to develop the OCS. In 43 U.S.C. § 1332(3), Congress declared as a matter of federal policy that the OCS "is a vital national resource reserve" that "should be made available for expeditious * * * development." See also, *e.g.*, H.R. Rep. No. 413, 83d Cong., 2d Sess. 2 (1953) (the "principal purpose" of the OCSLA was to authorize the leasing and development of the OCS, and the "importance and necessity" for the legislation reflected the congressional policy that "the development and operation of [the OCS] are vital to our national economy and security"). State taxes would burden this national policy; as Congress itself recognized with respect to royalties, payments should not be "made so high that companies will not feel like operating the lands." [35]

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this Court explained in *Watt* v. *Energy Action Educational Foundation*, 454 U.S. 151 (1981), "[i]n passing the 1978 Amendments, Congress committed the Government to the goal of obtaining fair market value for OCS oil and gas reserves" (*id.* at 162, citing 43 U.S.C. § 1344(a)(4)) and sought to " 'secure higher returns to the public Treasury' " (454 U.S. at 167 n.18, quoting H.R. Rep. No. 95-590, 95th Cong., 1st Sess. 47 (1977)). Indeed, by authorizing the Secretary of the Interior to experiment with systems of lease payments based on lessees' net OCS profits (454 U.S. at 155 & nn. 3, 5), the 1978 amendments gave the government a direct interest in the profitability of OCS production (see 454 U.S. at 166-167 n.18)—an interest that would be adversely affected by state taxation of OCS oil and gas income.

[35] 99 Cong. Rec. 6965 (1953) (remarks of Sen. Martin).

The policy of providing an incentive to companies to develop the OCS was reiterated in the 1978 amendments to the OCSLA. The amendments emphasized the continuing need for " 'discovering and recovering oil and gas' " and " 'developing new oil and gas resources in an efficient and timely manner.' " *Watt* v. *Energy Action Educational Foundation*, 454 U.S. at 164 n.16, quoting H.R. Conf. Rep. No. 95-1474, 95th Cong., 2d Sess. 92 (1978). See also *Secretary of Interior* v. *California*, 464 U.S. 312, 336 (1984). To that end, the

3. *The OCSLA prohibition of state taxation applies to all OCS income, whether the oil and gas is sold on or off the Shelf*

The text, history, and policies of the OCSLA demonstrate that state taxation of the income earned from the extraction of OCS oil and gas is inconsistent with federal law. However, the Solicitor General, in line with the concession of the State of Florida, has attempted to draw a distinction based on the place of sale of OCS production to a third party. In the government's view, an apportioned corporate income tax like that imposed by Iowa and Florida cannot include profits earned by the taxpayer-lessee from the sales of OCS oil or gas to a third party on the Shelf itself, but may include such profits if the taxpayer transports the oil or gas to the mainland and then sells it to a third party in the United States. We agree with the former but not the latter conclusion; nothing in the OCSLA carves out an exception to the state tax prohibition for OCS oil and gas that is sold off the Shelf.

a. *OCS production sold on the Shelf*

With respect to OCS oil and gas that is sold on the Shelf, the applicability of the OCSLA state tax prohibition is manifest. The income being taxed consists of nothing but the net value of the resources extracted from the OCS. That production has no geographical nexus to any area but the OCS at the time it is conveyed by the taxpayer-lessee.[36] And all of the events giving rise to the

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amendments were intended to " 'provid[e] the incentive of a fair profit to the oil companies, which must risk their investment capital' " (454 U.S. at 164 n.16, quoting H.R. Rep. No. 95-590, at 54), and to " 'increase the availability of funds for exploration' " (454 U.S. at 166 n.18, quoting S. Rep. No. 95-284, 95th Cong., 1st Sess. 46-47 (1977)).

[36] See *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207, 225-226 & n.10 (1980) (income from the sale of non-OCS oil and gas to third parties at the wellhead was allocated by statute to the situs state and excluded from apportionment).

lessee's tax liability for the income earned—the extraction of the oil and gas and the realization of gain through its sale—have occurred within this exclusive federal enclave. In the most literal sense, state taxes have, in contravention of the OCSLA, been "appl[ied] to the outer Continental Shelf" (43 U.S.C. § 1333(a)(2)(A)), and the state has "claim[ed]" an "interest" in the apportioned "revenues" from the OCS activities (43 U.S.C. § 1333 (a)(3)).

Moreover, the dual policies underlying the OCSLA—to promote development of the OCS through incentives to lessees, and to enhance the government's revenues from lease payments—are directly implicated in this situation. To tax the income of an OCS lessee who extracted and sold minerals entirely on the Shelf would impose a direct burden on the profitability of the OCS operation, thereby reducing the lessee's incentive to undertake development and lowering the value of the rights for which lease payments will be made to the government.[37]

Accordingly, as the Solicitor General acknowledges, and as Florida concedes, the OCSLA requires that state taxes exclude from the apportionable income base the earnings attributable to oil and gas that the taxpayer-lessee extracts from the OCS and sells to a third party on the Shelf.

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[37] In analogous circumstances in *White Mountain Apache Tribe* v. *Bracker*, 448 U.S. 136 (1980), the Court held that a state could not impose a tax on non-Indian logging companies operating on a federal Indian reservation because such taxation would interfere with the federal "policy of assuring that the profits derived from timber sales will inure to the benefit of the Tribe" and "would undermine the Secretary's ability to make the wide range of determinations committed to his authority concerning the setting of fees and rates with respect to the harvesting and sale of tribal timber"; as a result, state taxes would impermissibly "reduc[e] tribal revenues and diminish[] the profitability of the enterprise for potential contractors." *Id.* at 149.

b. *OCS production sold off the Shelf*

That the ultimate sale of OCS oil or gas occurs off the Shelf cannot obscure the fact that the apportioned state tax includes the net value of the production at the very point at which the federal lessee extracts it from the OCS. While it may be easier to conceptualize the statutory violation in spatial terms when the sale as well as the production takes place on the Shelf, state taxation of off-Shelf sales equally falls on OCS oil and gas. Nothing in the language of the OCSLA or its purposes turns on the location of the ultimate sale of OCS production; whether the taxpayer-lessee elects to sell it immediately on the Shelf, to sell it once it is brought to the mainland, or to refine it or store it for later sale, state taxation of the OCS production income is subject to the same statutory prohibition and has the same adverse consequences for federal OCS policies.

The Solicitor General's *amicus curiae* brief offers several grounds for not applying the OCSLA state tax prohibition to OCS oil and gas sold outside the Shelf, but none of these justifies the government's position. First, the Solicitor General asserts (U.S. Am. Br. 16) that the OCSLA merely "codif[ies] the constitutional proscriptions, set forth in the Due Process and Commerce Clauses, against state efforts to tax values that lie outside their jurisdiction." However, that interpretation renders the statutory prohibition of state taxation superfluous and largely trivializes Congress's extensive and often contentious debate over the issue of state taxing authority. The Congress that enacted the OCSLA certainly thought it was doing something more than simply incorporating a well-established and indisputable constitutional principle.

The Solicitor General also argues (U.S. Am. Br. 15, 17) that the proper construction of the OCSLA should not turn on fiscal considerations regarding the lease revenues paid to the federal government or the economic incentives afforded lessees to develop the OCS. The legislative his-

tory of the OCSLA makes clear, however, that these interests were of central concern to Congress. See pages 18-20, *supra*. Indeed, the Solicitor General's brief itself concedes that Congress recognized that state taxation of OCS oil and gas "would necessarily decrease federal revenues" (U.S. Am. Br. 15 n.11). Contrary to the government's characterization, there is nothing "incidental[]" (*id.* at 15 & n.11) about state taxation of the income earned on oil and gas that a federal lessee extracts from the OCS. The prohibition of state taxes is an integral aspect of Congress's policies to enhance lease payments to the federal treasury and to encourage development of the OCS.

In addition, the Solicitor General notes (U.S. Am. Br. 11, 14) that Congress did not specifically focus on apportioned state income taxes in enacting the state tax prohibition. But that is no more true for off-Shelf sales than for on-Shelf sales, which also are not expressly mentioned in the legislative history but which the government nonetheless recognizes cannot be included in apportionable income. More to the point, the language, history, and policies of the OCSLA indicate that the Act was intended to prohibit state taxation, in *any* form, of OCS oil and gas income. At every turn, Congress rebuffed the states' efforts to reap tax revenues from the OCS. The statute bars "[s]tate taxation laws" without exception. Congress was not required to identify and rule out each individual tax that was meant to be proscribed. See, *e.g.*, *Aloha Airlines* v. *Hawaii Director of Taxation*, 464 U.S. at 12 n.6; *Harrison* v. *PPG Industries, Inc.*, 446 U.S. 578, 592 (1980).[38]

[38] The Solicitor General further relies (U.S. Am. Br. 9 n.7) on 43 U.S.C. § 1335(a)(9), which provides for an increase in OCS royalties by the amount of "severance, gross production, or occupation taxes" payable to the state under leases it issued prior to the enactment of the OCSLA. Because the OCSLA unquestionably prohibits these taxes, and because the purpose of Section 1335(a)(9) was to prevent a windfall to existing lessees who were being relieved of state taxes they had expected to pay, the Solicitor General suggests that the absence of apportioned state income taxes from this enumeration means that they are not covered by the OCSLA state tax prohibition.

Finally, the Solicitor General contends (U.S. Am. Br. 5, 6, 9-10, 16) that states may tax off-Shelf sales because, under general principles of income tax law, the income from such sales is "realized" within the states rather than on the OCS. But technical concepts of income realization have no relevance here. The state tax prohibition at issue in this case is governed by the language and policies of the OCSLA, not the provisions of the Internal Revenue Code. And that standard does not vary according to the location of the eventual sale. The Solicitor General offers no reason why the congressional prohibition of state taxes should depend on the place or time that income is realized from OCS production rather than on the incontrovertible fact that the value of that production is being taxed.[39]

Once again, however, the Solicitor General, having conceded that states cannot tax the value of OCS production sold on the Shelf, derives no support from Section 1335(a)(9) for his argument that they nevertheless can tax precisely the same value in the case of off-Shelf sales. Moreover, given the differences in computing taxes based on net income and taxes (like severance, gross production, and occupation taxes) based solely on the volume of production, it would have been completely infeasible to add to the federal royalty payment the amount of the state income tax that would have been due. Nor were apportioned state income taxes as common in 1953 as they are now; for example, the Uniform Division of Income for Tax Purposes Act (UDITPA) was not adopted until 1957. See *ASARCO, Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, 310 n.3 (1982). In addition, Section 1335(a)(9) applies only to leases issued by the state prior to the enactment of the OSCLA; for all subsequent leases, the federal royalty is *not* increased by the amount of the prohibited state tax, a result that Congress recognized would inure to the advantage of OCS developers over their competitors operating on the mainland and subject to state taxation. See 99 Cong. Rec. 7259 (1953) (remarks of Sen. Daniel).

[39] See *Atlantic Richfield Co.* v. *Alaska*, 705 P.2d 418 (Alaska 1985), appeal dismissed, 106 S.Ct. 774 (1986) (Burger, C.J., and White and Stevens, JJ., dissenting):

Whatever the differences may be under the Internal Revenue Code (see U.S. Am. Br. 16), there are no differences, for purposes of the OCSLA, among sales of OCS production to a third party on the Shelf, sales to a related corporation on the Shelf, or (as occurred in this case) internal corporate transfers on the Shelf for later sale to third parties on the mainland. Even viewing the question through the distorting prism of the tax code, the Solicitor General recognizes (*ibid.*) that there is a "nonfrivolous argument that the policies of the Outer Continental Shelf Lands Act would not be furthered by such formal distinctions"; viewed through the proper prism of the OCSLA, the argument against such formal distinctions becomes compelling. If, as demonstrated above and as the Solicitor General acknowledges, the OCSLA prohibits states from taxing the value of OCS production sold on the Shelf, it also prohibits state taxation of the value of OCS production in connection with sales off the Shelf.

B. The Court Should Grant Review In This Case And Hold The Florida Case

For the reasons discussed above, plenary review of the Iowa Supreme Court's decision is fully warranted. The Iowa appeal includes the issue raised in the Florida case concerning state taxation of OCS production sold off the Shelf, as well as the additional issue of taxation of OCS production sold on the Shelf. Both issues should be decided by this Court, and this case—but not the Florida case—provides an opportunity to do so. Moreover, the factual record in this case was stipulated by the parties and therefore is especially manageable and useful in illuminating the legal issues presented.

Obviously, profits do not result from * * * oil production until the product is sold. This does not negate the fact that profits generated by the sale are partly attributable to the inherent value of the * * * oil at its point of production.

705 P.2d at 425.

Accordingly, because this appeal provides a far better vehicle for definitively resolving the issues presented in these cases, and because the Court's decision in the Iowa case also will control the Florida case, we suggest that the Court should note probable jurisdiction here and hold the Florida case for disposition in light of the Court's decision in this case.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

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APPENDICES

APPENDIX A

IN THE SUPREME COURT OF IOWA

[Filed October 21, 1987]

KELLY-SPRINGFIELD TIRE CO.,
Appellant,

vs.

IOWA STATE BOARD OF TAX REVIEW,
Appellee.

SHELL OIL COMPANY,
Appellant,

vs.

THE IOWA DEPARTMENT OF REVENUE,
Appellee.

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87-278
86-1565

Appeals from the Iowa District Court for Polk County, J. P. Denato and Joel D. Novak, Judges.

Consolidated appeals by corporate taxpayers in actions for judicial review of assessments of additional income taxes by Iowa Department of Revenue. (NO. 87-278) REVERSED AND REMANDED; (NO. 86-1565) AFFIRMED IN PART, REVERSED IN PART AND REMANDED.

Considered en banc.

CARTER, J.

These consolidated appeals raise two legal issues in regard to income tax assessments by the Iowa Department of Revenue (IDOR) being judicially reviewed under Iowa Code section 17A.19 (1985). These issues are: (1) whether assessment of additional corporation income taxes by IDOR against appellant Kelly-Springfield Tire Co. (Kelly-Springfield) in No. 87-278 and appellant Shell Oil Company (Shell) in No. 86-1565, made more than three years after the filing of the taxpayers' returns, was untimely under Iowa Code section 422.25(1) (1977) and therefore invalid; and (2) whether assessment of additional income taxes against Shell in No. 86-1565 was in violation of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1333(a). For reasons hereafter stated, we answer the first question in the affirmative and the second question in the negative, thus, affirming in part and reversing in part the decisions of the district court.

I. *Timeliness of Assessments Under Iowa Code Section 422.25(1) (1977).*

The record supports the taxpayers' contention that assessment of additional corporate income taxes by IDOR against Kelly-Springfield for the years 1971-78, inclusive, and against Shell for the years 1975-77, inclusive, were initiated more than three years after those taxpayers had filed corporate income tax returns for the years in question. Consequently, both Kelly-Springfield and Shell have contended both before the agency and throughout these judicial review proceedings that these assessments were untimely under Iowa Code section 422.25(1) (1977) and thus invalid.

Section 422.25(1) provides:

> As soon as practicable and in any event within three years after the return is filed the department shall examine it and determine the correct amount of tax, and the amount so determined by the department shall be the tax; provided that if the taxpayer omits from income such an amount as will, under the Internal Revenue Code of 1954, extend the statute of limitations for assessment of federal tax to six years under said Code, the period for examination and determination shall be six years; and provided further that the period for examination and determination shall be unlimited in the case of a false or fraudulent return with intent to evade tax or in the case of failure to file a return. Notwithstanding the periods of limitation for examination and determination heretofore specified, the department shall have six months to make an examination and determination from the date of receipt by the department of notice from the taxpayer of the final disposition of any matter between the taxpayer and the internal revenue service with respect to the particular tax year.

For each of the tax years in controversy, the Internal Revenue Service (IRS) had audited the taxpayers' returns. The additional assessments of Iowa income taxes were made within six months of receipt by IDOR of notice of the final disposition of the federal audit for the particular tax year. These additional assessments of Iowa income taxes, except for certain adjustments in Kelly-Springfield's tax liability for 1971, were unrelated to and not affected by any changes made in connection with the audit of the taxpayers' federal income tax liabilities.

The issue which was framed at the contested case hearing was whether IDOR's right of examination and determination of additional state tax liability during the extended six-month period following the conclusion of a federal audit is unlimited in scope or is limited to corrections resulting from action taken in the federal audit.

Following the contested case hearing, IDOR concluded that its right of examination and determination for six months following a federal audit is unlimited in scope. The district court agreed with that conclusion.

The primary argument advanced by IDOR to sustain its interpretation is that the words "examination and determination," which appear several times within section 422.25(1), are in no instance qualified with respect to the scope of the inquiry IDOR is permitted to make. Because the scope of the examination and assessment of additional tax is concededly unlimited in the other circumstances where the phrase "examination and determination" appears in the statute, IDOR argues that consistency in the application of identical statutory language requires an unlimited examination also be permitted in the present situation.

In response to this argument, the taxpayers urge that an exception to a general period of limitation which is triggered by the occurrence of a particular event must be interpreted in some manner which is relevant to that event. The mere occurrence of a federal audit is not, taxpayers argue, relevant to whether the limitation period for imposing state tax liability should be extended. It only becomes relevant, they suggest, if action taken in the federal audit alters some basic premise on which the taxpayer's state tax liability was initially reported.

We find the taxpayers' interpretation to be more plausible than the one proposed by IDOR. A court construing a statute to ascertain legislative intent must not only consider the language used, but must also take account of the object sought to be accomplished or the problems sought to be remedied and arrive at a construction that will best effect its purpose. *Matter of Girdler*, 357 N.W.2d 595, 597 (Iowa 1984); *In Interest of G.R.*, 348 N.W.2d 627, 631 (Iowa 1984); *Lau v. City of Oelwein*, 336 N.W.2d 202, 203 (Iowa 1983).

The extended period of examination following the conclusion of a federal audit was inserted in section 422.25 (1) by 1957 Iowa Acts chapter 211, section 1. The determination of the primary objective of such an amendment requires reference to the prior state of the law and the circumstances surrounding the amendment's enactment. *City of Des Moines v. Public Employment Relations Bd.*, 275 N.W.2d 753, 760 (Iowa 1979). Applying these principles to the present case it appears that, prior to the enactment of the 1957 amendment, it was established as the legislative policy of this state that examination and determination of the proper amount of tax was to be made by IDOR within three years of the filing of the taxpayer's return except in certain situations of taxpayer omission not relevant here.[1] The interpretation proposed by IDOR is, we believe, incompatible with the basic premise upon which section 422.25(1) is based, *i.e.*, that unless certain enumerated circumstances have occurred which preclude the agency from making an accurate assessment of Iowa taxes within the three-year period its right of examination is barred.

We find nothing in the 1957 amendment which suggests a retreat from this overriding policy. Rather, the federal audit exception to the three-year limitation appears to be a fair way of dealing with changed circumstances resulting from the federal examination. The exception is therefore available to IDOR only if adjustments made by the internal revenue service create a change of circumstances affecting the taxpayer's Iowa tax liability. The rather short period of time granted IDOR to make adjustments of Iowa tax liability following the conclusion of the fed-

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[1] This policy has existed for more than 50 years. Beginning in 1934, the limitation period was established at two years. 1934 Iowa Acts ch. 82, § 21 (45 Ex. G.A.). It was increased to three years in 1955. 1955 Iowa Acts ch. 210, § 1.

eral inquiry supports our conclusion that the examination is limited in scope.[2]

In *Commonwealth v. Lukens Steel Co.*, 402 Pa. 304, 167 A.2d 142 (1961), the court interpreted a Pennsylvania statute which provided that,

> [I]f at any time the net income as returned by any corporation to the federal government is finally changed or corrected by the commissioner of internal revenue or by any other agency or court of the United States with a result that tax, in addition to the amount paid, is due under this act, the department is hereby authorized and empowered to make a resettlement of the tax due by such corporation, based upon the facts contained in the report, or upon any information within its possession or that shall come into its possession.

Pa. Stat. Ann. Tit. 72, § 3402h(c) (Purdon 1964). Notwithstanding the rather broad language in the final sentence of the statute, the court reasoned that its legal effect was to extend the limitation period only for purposes of making assessments of state income taxes due as a result of federal adjustments. The court indicated a contrary ruling would render absolutely meaningless the provisions of the act establishing a general time limit for resettlement. 402 Pa. at 309-10, 167 A.2d at 145. *See also McLean Trucking Co. v. Lindley*, 70 Ohio St. 2d 106, 111, 435 N.E.2d 414, 417 (1982) (general limitation period absolute bar to assessment of additional state

[2] Another factor which suggests that the legislature intended a limited scope of examination is that legislative enactments contained in 1955 Iowa Acts ch. 210, § 2, which shifted to the state the burden of proof in areas where the right of examination is unlimited, were not made applicable to the extended period of examination following a federal audit. This suggests a legislative intent that the factual basis for reexamination of Iowa tax liability in the latter situation would turn on the result of the federal audit and not involve other areas of disputed fact.

taxes unrelated to corrections made by internal revenue service).

IDOR argues that, notwithstanding the matters which we have discussed, its long-standing interpretation of the statute should be given some weight. Although the interpretation of the statute proposed by IDOR in the present case may have been the department's position for some time, it should be noted that it has issued no published rule or directive codifying that position. As we have stated in another revenue case involving statutory interpretation, "the meaning of a statute is always a matter of law, and final construction and interpretation . . . is for this court." *Sorg v. Iowa Dep't of Revenue*, 269 N.W.2d 129, 131 (Iowa 1978). *See also City of Des Moines*, 275 N.W.2d at 759-60. We hold that any adjustment by IDOR to the taxpayers' liability in the present cases which was not initiated within three years following the filing of returns was untimely and invalid except as it relates to changes required by the federal audit. This requires a reversal of No. 87-278 and a reversal of No. 86-1565 on this issue.

II. *Claims Involving Taxation of Revenues Derived From Outer Continental Shelf Lands.*

The next issue, involving only claims by Shell in No. 86-1565, concerns an alleged limitation on the power of the states to tax activities occurring on outer continental shelf (OCS) lands which Shell suggests is contained in the Outer Continental Shelf Lands Act, 43 U.S.C. section 1333(a).

The record reflects that Shell is a Delaware corporation engaged in a unitary business consisting of exploration for oil and the development, production, transportation, purchase and marketing of crude oil, natural gas, and chemical products. During the years at issue, certain of Shell's gross revenues were derived from sale of products extracted from OCS lands. During this period, Shell sold

all of its OCS natural gas at the platform on OCS lands. In contrast, most of Shell's crude oil was transferred off OCS lands to other locations prior to being marketed. Shell's principal business in Iowa during this period consisted of marketing oil and chemical products which had been refined and manufactured outside Iowa.

In accordance with Iowa Code section 422.33(2)(b)(4), Shell's Iowa net income was derived by application of an apportionment formula wherein "the part attributable to business within the state shall be in that proportion which the gross sales made within the state bear to the total gross sales." Because its gross revenues for these years contained amounts realized from the disposition of OCS products, Shell maintains that it was improper for the state of Iowa to give any consideration to revenue from OCS sources in the application of the statutory apportionment formula utilized to determine its Iowa income tax liability.

In advancing this argument, Shell relies upon language contained in subparagraphs 2(A) and (3) of section 1333(a) of the OCSLA, which provides, in part, as follows:

> (2)(A) To the extent that they are applicable and not inconsistent with this subchapter or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State, now in effect or hereafter adopted, amended, or repealed are hereby declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines

> extending seaward and defining each such area. All of the applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. *State taxation laws shall not apply to the outer Continental Shelf. . . .*
>
> (3) The provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, *or the property and natural resources thereof or the revenues therefrom.*

(Emphasis added.) Shell views the foregoing statutes as a Congressional directive designating any return from its OCS land transactions as federally protected income and, therefore, not includable in the Iowa tax base. In so arguing, it relies upon the decisions of *Aloha Airlines, Inc. v. Director of Taxation of Hawaii*, 464 U.S. 7, 104 S. Ct. 291, 78 L. Ed. 2d 10 (1983), and *Ramah Navajo School Board, Inc. v. Bureau of Revenue of New Mexico*, 458 U.S. 832, 103 S. Ct. 3394, 73 L. Ed. 2d 1194 (1982).

We do not agree that these cases support Shell's contentions. The policies underlying the federal legislation applied in the *Aloha Airlines* and *Ramah Navajo School Board* cases were clearly indicated to be such that the application of local taxing statutes would have undeniably frustrated the goals which Congress was attempting to promote. In contrast, Shell has indicated no particular area of Congressional policy in the management and control of the OCS lands which is frustrated by the state of Iowa applying a traditional measure of apportionment in order to obtain a valid local nexus for taxation purposes.[3]

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[3] In defining the term "unitary business" for purposes of apportioning income, Iowa Code § 422.32(5) refers to a business carried on partly within and partly without a state where the portion of

The issue is, of course, entirely one of statutory interpretation. The Florida Supreme Court in *Shell Oil Co. v. Department of Revenue*, 496 So. 2d 789, 791 (Fla. 1986), has rejected the interpretation which Shell seeks to place on 43 U.S.C. sections 1333(a)(2)(A), (3). In that case, the court concluded that the realization of the income by Shell occurred within the legislative jurisdiction of the taxing state. The facts of the present case differ slightly from those in the cited case because the Florida revenue officials had excluded from their apportionment formula that portion of Shell's gross revenues which were derived from sales made on OCS lands. In the present case, Iowa has apparently included in its gross apportionment formula some revenues derived by Shell from the sale of natural gas at the platform on the OCS. We do not believe, however, that this distinction warrants a result in the present case which differs from the one reached by the Florida court.

In reviewing the legislative history of the OCSLA, we are convinced that the language restricting the application of state taxation laws to the OCS and denying to the state any interest in the natural resources or revenues from the seabed and subsoil of the OCS was intended as a limitation on the authority of states adjacent to OCS lands to extend legislative jurisdiction to the OCS. The legislation in question was the culmination of an historical tug-of-war between state and federal interests in the region. In a pertinent report on the legislation by the Senate committee, it was stated:

> It is the Committee's collective judgment that under the terms S. 1901 as reported, State taxation laws

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the business carried on within the state depends on or contributes to the business outside the state. Section 432.32(10) defines "State" so as to include "any territory or possession of the United States." We conclude that the OCS lands are a territory of the United States so as to be includable within this definition.

> necessarily are excluded from applicability in this area of exclusive Federal jurisdiction not inside the boundaries of any state. Paragraph (3) of Section 4(a) specifically commands that—
>
> > The provisions of this section for adoption of the State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any state for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom.
>
> S. Rep. No. 411, 83rd Cong., 1st Sess. (1953).

Iowa's imposition of the challenged corporation income taxes on Shell for the years 1975-80, inclusive, is in no way dependent upon the exercise of legislative jurisdiction on OCS lands. Its taxing jurisdiction depends instead on the nexus of Shell's activities within this state. The inclusion of some OCS revenues in the apportionment formula is simply a method of obtaining an acceptable measure of the local nexus.[4] This principle was illustrated in *Moorman Manufacturing Co. v. Bair*, 254 N.W.2d 737 (Iowa 1977), *aff'd*, 437 U.S. 267 (1978). In further amplifying the principles established in its affirming opinion in *Moorman*, the Supreme Court stated in *Mobile Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 100 S. Ct. 1223, 63 L. Ed. 2d 510 (1980):

> "[T]he entire net income of a corporation generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes

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[4] In this regard, the nature of the tax differs substantially from the "first-use" tax involved in *Maryland v. Louisiana*, 451 U.S. 725, 101 S. Ct. 2114, 68 L. Ed. 2d 576 (1981). Shell's reliance on that case is also misplaced because it was not decided under the OCSLA but instead involved the Natural Gas Policy Act.

> by formulas utilizing in-state aspects of interstate affairs." [citing *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-73, 98 S. Ct. 2340, 2344, 57 L. Ed. 2d 197, 204 (1978)] . . . The requisite "nexus" is supplied if the corporation avails itself of the "substantial privilege of carrying on business" within the State, and "[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction."

Id. at 436-37, 100 S. Ct. at 1231, 63 L. Ed. 2d at 520 (other citations omitted).

Shell's argument that somehow the source of the revenues prohibits their inclusion in the apportionment formula is only valid if it was the intent of Congress to prohibit that result. In seeking to determine that intent, we begin with the recognition that the pattern of apportionment of gross revenues, regardless of source, for purposes of determining local taxability is well established within our federal system. As observed in *Mobile Oil Corp.*:

> In the past, apportionability often has been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities formed part of a single unitary business. . . . In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. . . . Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize

> the income of the business as having a single identifiable "source." Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required.

Id. at 438, 100 S. Ct. at 1232, 63 L. Ed. 2d at 521 (citations omitted).

In deciding whether Iowa's taxing statutes offend against Congressional policies of management and control of OCS lands, it is preferable, we believe, to focus on the tax consequences which are produced by applying the apportionment formula rather than focusing on the various elements which are inserted into the equation in order to produce those consequences. Shell's argument fails to indicate how the impact of applying the apportionment formula detracts in any identifiable way from Congressional policy relating to OCS lands.

The inclusion of OCS revenues in gross sales for purposes of applying the statutory apportionment formula contained in Iowa Code section 422.33(2)(b)(4) apparently aids in obtaining an accurate measure of the tax to be imposed as a result of Shell's Iowa activities.[5] That, of course, is the goal of any apportionment formula. We cannot attribute to Congress an intent to impede this legitimate goal in the absence of some compelling indication that such was its intention in passing the OCSLA. We fail to divine any such intention from either the legislative history or language of the Act. We conclude that the district court properly rejected Shell's petition for judicial review on this issue.

Based upon our determination of the issues presented, the judgment of the district court in No. 87-278 is reversed and that case is remanded to the agency for further proceedings not inconsistent with this opinion. The

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[5] See n.3, *supra*.

judgment of the district court in No. 86-1565 is in all respects affirmed on the issues involving application of 43 U.S.C. section 1333(a) and is reversed on the issues involving the application of Iowa Code section 422.25(1). As to the latter issues, the case is remanded to the agency for further proceedings not inconsistent with this opinion. The costs of appeal in No. 87-278 are taxed to appellee. The costs of appeal in No. 86-1565 are taxed seventy-five percent to appellant and twenty-five percent to appellee.

(NO. 87-278) REVERSED AND REMANDED; (NO. 86-1565) AFFIRMED IN PART, REVERSED IN PART AND REMANDED.

All justices concur except Snell, J., who takes no part.

APPENDIX B

IN THE IOWA DISTRICT COURT FOR POLK COUNTY

No. AA 952
RULING

SHELL OIL COMPANY,
Petitioner,

vs.

THE IOWA DEPARTMENT OF REVENUE,
Respondent.

[Filed Oct. 3, 1986]

This matter came on before the Court on June 27, 1986 upon the Petition for Judicial Review of the decision of the Iowa Department of Revenue (hereinafter "the Department"). Petitioner (hereinafter "Shell" or "Shell Oil") was represented by William Peltz, General Tax attorney, Shell Oil Company, and attorney James W. Hall. The Department was represented by Harry M. Greiger, Special Assistant Attorney General. After reviewing the record, briefs and having considered the statements and arguments of counsel, the Court makes the following ruling.

STATEMENT OF THE CASE

The Court has jurisdiction over the subject matter of this action and over the parties hereto. This is an application for judicial review of an adverse decision in a con-

tested case after all administrative remedies have been exhausted.

The parties filed a stipulation prior to the administrative hearing. The stipulation, after deletion of nonfactual material, arguments and controverted material, was adopted by the hearing officer as part of the Findings of Fact. This Court adopts and fully incorporates the Findings of Fact of the parties stipulation in its entirety, as well as Findings of Fact Nos. 47 through 51 of the Hearing Officer's Order. The relevant portions of the adopted and incorporated Findings of Fact are set out below:

STIPULATION

I

GENERAL DESCRIPTION OF SHELL OIL COMPANY

1. Shell Oil Company ("Shell") is a Delaware corporation with business operations in all fifty states and the District of Columbia.

2. During the years 1975 through 1980, Shell was the parent member of an affiliated group of corporations, the principal business of which is the exploration for, and development, production, transportation, purchase, and marketing of crude oil and natural gas, and the purchase, manufacture, and marketing of oil and chemical products. Shell is a vertically integrated oil company which itself engages in the business activities set out above and also set forth in paragraph 4(b)(1) of the Protest and in Shell's annual 10K reports, Exhibits A, B, C, D, E, and F.

3. During the years 1975 through 1980 Shell Oil Company conducted the majority of its business activities as two separate operating organizations, the Products Organization and the Exploration and Production (E&P) Organization. . . . The E&P Organization is responsible for locating and acquiring rights to develop and produce crude oil, gas, and other natural resources. The production resulting from E&P Organization's activities is Shell's major single supply of raw material. The Products Organization is responsible for the transportation, purchasing, and marketing of crude oil and natural gas liquids, and the manufacture and marketing of petroleum and chemical products. The Products Organization's products are refined and manufactured from feedstock (crude oil and natural gas) obtained from the E&P Organization or purchased from others. The Products Organization does not perform any funetions on the Outer Continental Shelf (OCS).

4. The Products Organization has two major operating segments; Oil Products and Chemical Products. . . . The Products Organization obtains part of its crude oil requirements from Shell's E&P Organization to Shell's Products Organization, the transfers were recorded by Shell as sales at posted industry prices with appropriate adjustments for gravity and transportation, but no money was paid for such intracompany transfers. Such transfers at posted industry prices involved crude oil production in the OCS and non-OCS areas. See paragraph 23, *infra*. During the years 1975 through 1980 Shell was a "net purchaser" of crude oil, its E&P Organization provided from a law of 48.6 percent of the Products Organization's crude oil in 1977 to a high of 60.7 percent in 1980. The balance of Shell's crude oil requirements was acquired by way of purchase by the Products Organization. Such purchases included purchases from domestic sources (including purchases from other OCS producers) and from foreign sources.

5. . . . .

6. During 1975-80, within the State of Iowa, Shell's principal business consisted of marketing oil and chemical products refined and manufactured by the Products Organization. There were crude oil based Shell-manufactured products sold in Iowa which were manufactured from

crude oil which was commingled to the extent that the ultimate source (OCS or non-OCS) of the crude oil could not be determined with any degree of certainty. . . .

7. Shell's activities as described in paragraph 2 of this Stipulation, including its activities on the OCS, constitute a unitary business, a portion of which, as stated in paragraph 6, was carried on within the state of Iowa during the years 1975 through 1980. Shell's activities are substantially similar to those described in the case of *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980).

II

OUTER CONTINENTAL SHELF OPERATIONS

AREA INVOLVED

8. Under the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1331, *et seq.*, the Outer Continental Shelf (OCS) is defined as "all submerged lands lying seaward and outside the area of lands beneath navigable waters as defined in Section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control" 43 U.S.C. 1331(a). Section 1301 of title 43 U.S.C. is part of the Submerged Lands Act (43 U.S.C. 1391 *et seq.*) and defines "land beneath navigable waters" as essentially that area within three miles of the coast line of the United States. (Texas owns 3 marine leagues into the Gulf of Mexico.) In short, the Outer Continental Shelf is the submerged land, as defined in 43 U.S.C. § 1331(a), which lies beyond the 3-mile limit. Rather than being a geographic feature, as would be inferred from its name, the OCS is a legal term describing the land extending seaward from a state's offshore boundary under water over which the United States claims economic or territorial jurisdiction. As such the OCS is not located in the State of Iowa or any other of the 50 states,

so during 1975 through 1980 the actual extraction of OCS minerals did not occur in Iowa or any of the other 50 states. The OCS surrounds the continental 48 states, Alaska and Hawaii.

9. The rights to explore for, develop and produce hydrocarbons (oil and gas) from beneath the OCS were conveyed by the federal government to private enterprises by way of lease sales. During the years at issue specific tracts of OCS land were selected to be the subjects of lease sales. The size of these tracts ranged from 750,000 to 1 million acres and the leases were usually in 5,000 or 5,760 acre blocks. The lease sale was advertised in the Federal Register at least 30 days before the sale with the sale date, place and time, the tracts to be offered, and the royalty amount (usually 1/6) set by the government. . . .

The successful bidder received an oil and gas lease pursuant to the terms advertised in the announcement of the sale. Generally, the terms of the lease provided for a 1/6 royalty and gave the successful bidder the exclusive right to explore, develop, and produce petroleum from beneath the area awarded. The initial term (that time period during which actual extraction of gas or oil must begin) was usually five years. There was generally a rental provision of $3 per acre per year. Rent was to be paid each year in advance during the initial five year period or until the start of production; after production started the rent would be paid in the form of a royalty based on production.

The term of the lease was to run for as long as there was production; absent production the lease would expire at the end of the five year initial term. The lease would of course terminate on abandonment or surrender by the leasee. Upon termination of the lease for any reason, the structures built thereon were to be removed and any

wells to be plugged and abandoned in accordance with government regulations.

. . .

Shell has onshore leases or owns land from which it extracts oil and gas which is not part of the OCS. Shell was and is constantly exploring for oil and gas in non-OCS areas.

(Paragraphs 10 through 20 omitted.)

21. Test facilities are maintained in the OCS to ensure the quality of the crude oil delivered to the pipeline operator. And, of course, metering facilities are necessary to determine how much product is delivered to the pipeline operator. The pipeline servicing the platform may be owned by Shell or owned by an independent third party. Once the crude oil is in the pipeline it is transported to shore (continental United States) for delivery to a refinery or other manufacturing facility of either Shell or an unrelated refinery or manufacturer. The refined and manufactured products are marketed throughout the world. Most, but not all, of the crude oil extracted by Shell from the OCS wells was brought from the OCS to the continental United States. This crude oil was either refined in Shell's refineries in the continental United States, or was exchanged by Shell with other oil companies. The portion of that crude oil which was refined was either sold or exchanged. These exchanges were with other companies in the Petro-Chemical industry.

As is done with respect to crude oil, test facilities are maintained on the OCS to ensure the quality of a natural gas delivered to the pipeline operator, and metering equipment is used to measure the amount of natural gas transferred. All of Shell's OCS natural gas production is sold to pipeline companies at the producing platform on the OCS.

(Paragraphs 22 through 25 omitted.)

Shell files tax returns with every state (45 states and the District of Columbia) that has an income tax or a franchise tax measured by income. With the exception of Mississippi, Oklahoma, Alaska (for 1978-81). Iowa (for 1977-80) and Florida, Shell apportioned its net income to all other states (without deduction of its separately-computed OCS net income, all as computed by Shell pursuant to the procedures in Exhibit 7) on the basis of a three-factor formula. Shell, in filing state income tax returns, has never excluded its total OCS value of production from the pre-apportionment net income base pursuant to the procedures in Exhibit 7. Shell's factors for use in the three-factor formula in the years at issue are set out in Exhibit 9, attached hereto. Had Shell deducted its separately-computed OCS net income in the just-stated computation, Shell would have paid less tax in each of those states in each of the years at issue with the exception of 1978. [In 1978 the effect of the reduction of apportionable income by the amount of OCS net income would not have offset the increase in apportionable income caused by the increase in the apportionment formula percentage due to the removal of OCS property, payroll and sales from the apportionment factors.] Had Shell deducted its total OCS value of production it would have paid less tax in every year.

III

JURISDICTIONAL AND STATUTE OF LIMITATIONS FACTS

26. Shell keeps its books and records on the accrual method of accounting and its income is reported on a calendar year basis.

27. Shell timely filed Iowa Corporation Income Tax Returns, Forms IA 1120, for the years in issue as follows in accordance with extensions to file procured pursuant to Iowa Code Sections 422.21 and 422.38:

Taxable Year	Date Filed
1975	October 23, 1976
1976	October 18, 1977
1977	October 25, 1978
1977 amended	March 12, 1980
1978	October 30, 1979
1979	October 23, 1980
1980	October 27, 1981

28. During the period March 8, 1982, through approximately March 12, 1982, the Iowa Department of Revenue ("Department"), by and through its auditors, conducted a field audit of Shell's corporate income tax returns relating to calendar tax years 1975-80 inclusive.

29. On or about April 19, 1982, Shell received an unsigned document designated Notice of Adjustment and Deficiency For Corporation Income Tax, Form No. 96-051 (Notice of Adjustment). The Notice of Adjustment was dated April 15, 1982, and bore the account number 00007975003. The Notice of Adjustment reflected proposed additional tax amounts due or (refund due) as follows:

Taxable Year	Tax
1975	$ 143,345.90
1976	204,941.00
1977	43,129.46
1978	8,755.20
1979	(117,024.70)
1980	(40,110.50)
Total	$ 243,036.36

The above amounts are exclusive of interest.

30. Attached hereto as Exhibit 10 is a copy of the Notice of Assessment For Corporation Income Tax, Form No. 96-052 (Notice of Assessment), dated June 10, 1982,

which was received by Shell on or about June 14, 1982. The Notice of Assessment reflected additional Tax Amounts due for the periods 1975 through 1980 identical to those set out on the Notice of Adjustment referenced in paragraph (27) above.

31. On September 1, 1982, within the lawful 90 day period following the Department's issuance of the Notice of Assessment referenced in paragraph (28) above, Shell filed a written protest pursuant to Sections 422.28 and 422.41 of the Iowa Code setting forth its specific objections to the assessment.

32. The audit adjustments underlying the Department's assessment notification relate to the Department's interpretation of Iowa statutes, regulations and case law. None of the adjustments which are the subject of the assessment and this contested case proceeding are the result of any adjustment made in any audit by the Internal Revenue Service for any taxable year.

33. Shell and the Department have not entered into any waiver agreement authorized by Iowa Code Section 422.25(7).

34. The amount in controversy for each taxable year, to the parties' knowledge, does not fall within those items of gross income defined in the Internal Revenue Code of 1954, as amended, as will under that Code extend the statute of Limitations for Federal tax purposes to six years, as set forth in Iowa Code Section 422.25(1). Accordingly, to the parties' knowledge Shell's returns for years 1975, 1976 and 1977 could not be examined by the Department on the basis of a six year Statute of Limitations in Section 422.25(1) commencing from the time each such return was filed or became due, whichever time is later.

35. The amount in controversy for each taxable year is not, to the parties' knowledge derived from false or fraudulent returns made with the intent to evade tax.

36. The amount in controversy for each taxable year was not assessed because of either the carryback of net operating losses or of net capital losses. Shell had overpaid its estimated Iowa income taxes for 1979 and 1980.

37. Shell has not at any time relevant herein forwarded to the Iowa Department of Revenue a written notification concerning the final disposition of any matter or controversy existing between it and the Internal Revenue Service (IRS) with respect to any of the years in question, 1975-1977 inclusive. In addition, Shell has not sent to the Department a copy of any Federal document purporting to show the final disposition or final Federal adjustment for any of the years in question, 1975-1977 inclusive.

38. By execution of IRS Forms 872, the limitation of time for the assessment of any deficiency in Shell's reported liability for Federal income tax for the year 1975 was extended to March 31, 1980.

39. In March 27, 1980, Shell received a statutory notice of deficiency dated March 25, 1980, with respect to Shell's Federal income tax liability for 1975. This statutory notice of deficiency arose out of an audit by the IRS of Shell's 1975 Federal income tax return. The IRS made purported adjustments to Shell's Federal taxable income.

40. On August 11, 1980, Shell paid the liability stated on the March 25, 1980 Notice of Deficiency.

41. On February 23, 1981, Shell filed a claim for refund of the amount paid on August 11, 1980. As of the date that this stipulation is filed no final decision has been made by the IRS regarding that claim for refund.

42. On December 28, 1981, the IRS sent Notices of Deficiency to Shell setting out deficiencies in Shell's Federal income tax for the years 1976 and 1977. On or about March 26, 1982, Shell filed a petition in the United

States Tax Court (Docket No. 6784-82) for a redetermination of the deficiencies set forth in those Notices of Deficiency; the petition also claimed refunds for the years 1976 and 1977. As of even date no decision has been entered in that case. This statutory notice of deficiency arose out of an audit by the IRS of Shell's 1976 and 1977 Federal income tax returns. The IRS made purported adjustments to Shell's federal taxable income for years 1976 and 1977.

(Paragraphs 43 through 51 omitted.)

During the years 1975-80 Shell owned and operated crude oil gathering systems (pipelines) on the Outer Continental Shelf. Those systems were used to transport crude oil from production platforms owned by Shell and others on the OCS to common carrier pipelines which completed the transportation of the crude oil from the OCS to onshore distribution or processing points.

All of the crude oil transported in Shell's gathering system was owned or controlled by Shell at the time it entered the gathering system. Shell purchased or received on exchange the non-Shell produced crude oil prior to its entry into the Shell gathering system.

During 1975-80 the fees charged for the transportation of crude oil in Shell's gathering system were calculated to derive maximum economic benefit to Shell. However, due to government controls, fluctuations in production and unpredictable mechanical difficulties with the gathering system the net income earned by the gathering system varied from year to year.

CONCLUSIONS OF LAW

Shell raises two issues on review. The first is whether the Department's Notice of Assessment of June 10, 1982 results in the taxation of net income derived by Shell from the Outer Continental Shelf (OCS) in violation of the Outer Continental Shelf Lands Act (OCSLA) and the

Supremacy Clause of the United States Constitution. The second issue raised by Shell is whether the Department was required to make its assessment for additional tax against Shell for the years 1975, 1976 and 1977 within three years from the date Shell filed the respective tax returns.

OCSLA

Iowa Code § 422.33(1) provides, in pertinent part, as follows:

. . . . .

> 1. If the trade or business of the corporation is carried on entirely within the state, the tax shall be imposed on the entire net income, but if such trade or business is carried on partly within and partly without the state, the tax shall be imposed only on the portion of the net income reasonably attributable to the trade or business within the state, said net income attributable to the state to be determined as follows:
>
> b. . . . . .
>
> Where income is derived from the manufacture or sale of tangible personal property, the part thereof attributable to business within the state shall be in that proportion which the gross sales made within the state bear to the total gross sales.
>
> . . . . .

Section 422.33 establishes a "one factor" formula to determine the amount of a multistate corporation's net income which can reasonably be allocated to the State of Iowa for tax purposes. The one factor formula eliminates the property and payroll factors that previously were considered in the "three factor" formula. In *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197 (1978), the Supreme Court upheld the constitutionality of Iowa's one factor formula for apportioning income.

The formula for calculating that portion of a multistate corporation's income subject to Iowa income tax under the one factor formula is as follows:

$$\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales}} \times \text{Federal Taxable Income Adjusted Per Iowa Law} = \text{Iowa Income}$$

Shell does not contend that Iowa is prohibited from using a one-factor formula. Rather, Shell contends that the Outer Continental Shelf Lands Act requires that Iowa make adjustments to the one factor formula to exclude from state taxation any income Shell derives from its Outer Continental Shelf activities.

Shell calculated its Iowa taxable income for the years in dispute as follows:

$$\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales} - \text{OCS Gross "Sales"}\ ^{1}} \times \text{Non OCS Taxable Income} = \text{Iowa Income}$$

Shell relies on the language of the Outer Continental Shelf Lands Act as authority for excluding its OCS income. The OCSLA provides, in pertinent part, as follows:

> 43 U.S.C. Section 1333(a)(1)
>
> The Constitution and laws and civil and political jurisdiction of the United States are hereby extended to the subsoil and seabed of the outer Continental

---

[1] Shell does not actually have any significant OCS "sales". Shell's OCS "sales" and "income" are derived from an internal accounting procedure which credits Shell's exploration and production division with "sales" at posted industry prices for transfers of oil and gas to Shell's Products division (Stip., par. 4). Only Shell's Product Division had Iowa activities (Stip., par. 6) and the Products Division is not involved in any activities on the OCS (Stip., par. 3)

Shell has commingled OCS and non-OCS oil to the extent that the ultimate source of the crude oil (OCS or non-OCS) for Shell manufactured products sold in Iowa could not be determined with any degree of certainty (Stip., par. 6).

Shelf and to all artificial islands, and all installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exploring for, developing, or producing resources therefrom, or any such installation or other device (other than a ship or vessel) for the purpose of transporting such resources, to the same extent as if the outer Continental shelf were an area of exclusive Federal jurisdiction located within a State: Provided, however, That mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of this Act.

(2)(A) To the extent that they are applicable and not inconsistent with this Act or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State now in effect or hereafter adopted, amended, or repealed are hereby declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines extending seaward and defining each such area. All of such applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. *State taxation laws shall not apply to the Outer Continental Shelf.*

(3) The provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural re-

sources thereof or the revenues therefrom. (Emphasis added.)

The Outer Continental Shelf is defined as "all submerged lands lying seaward and outside the area of lands beneath navigable waters as defined in Section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control". 43 U.S.C. Section 1333(a). Rather than being a geographic feature, as would be inferred from its name, the OCS is a legal term describing the land extending seaward from a state's offshore boundary under water over which the United States claims economic or territorial jurisdiction. (Stip. par. 8).

The OCSLA, including the prohibition on state taxation, was enacted in 1953. Prior to 1977, Shell never made any deduction on its Iowa return for a separately calculated OCS net income. In fact, with the exception of recent OCS income deductions in four other states, Shell does not deduct separately-computed OCS net income for any of its income tax returns filed in other states (Stip., par. 25). If Shell were to ultimately prevail in its contention that the OCSLA prohibits any state tax law which uses OCS activities to attract tax (*see* Reply Brief of Petitioner, p. 25), then Shell has indeed discovered a dormant tax shelter of enormous proportions for the oil and gas industry, given the size of soil and gas reserves on the OCS.[2]

See Exhibit E, 1979 Shell Annual Report, p. 6 ("Shell believes the offshore has the nation's greatest potential

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[2] Shell currently is attacking Iowa's apportionment scheme for income tax purposes only. If Shell is correct in asserting that the products of OCS activities cannot be used by states to attract tax, then it follows that state sales and road use taxes on OCS oil and gas would likewise be prohibited. OCS oil and gas clearly would be the product attracting such taxes; a practice which Shell argues is prohibited by the OCSLA.

for large discoveries, and could produce 60 percent of the 60 billion barrels of new oil and 35 percent of the 315 trillion cubic feet of new gas we estimate remains to be found in the U.S.")

Shell has made numerous arguments supporting its contention that Iowa's apportionment scheme taxes Shell's OCS income. The Department does not concede that Iowa's single factor formula for apportioning income taxes any of Shell's OCS income or that Shell's "separate accounting" proves that Shell even had any OCS income. While there may be some merit to the Department's argument in this regard, it is not necessary for the Court to address these issues. For the reasons stated below, the OCSLA simply does not prohibit states from applying constitutionally permissible formula apportionment schemes to income derived from OCS activities.

The Outer Continental Shelf Lands Act was the culmination of a prolonged dispute between the federal government and states adjacent to the OCS over territorial jurisdiction and the right to lease submerged lands for oil and gas exploration. *See U.S. Code Cong. and Ad. News*, 1385-1640 (1953). Historically, states adjacent to submerged lands owned and exerted jurisdiction over the submerged lands, including the underlying oil, gas and mineral deposits. *U.S. Code Cong. and Ad. News*, 1497-98 (1953). Some states had extended their boundaries as far as the outer edge of the shelf. *Id.* at 1391. However, a series of Supreme Court decisions held that the federal government, not the states, had paramount right to submerged lands, even within the historic boundaries of the states of California, Louisiana, and Texas. *United States v. California*, 332 U.S. 19 (1947); *United States v. Louisiana*, 339 U.S. 699 (1950); and *United States v. Texas*, 339 U.S. 707 (1950).

It was in this context that the issue of state taxation of OCS activities arose. The OCSLA resolved the issue

of ownership of the OCS in favor of the federal government. The focus on taxation was exclusively on states adjacent to the OCS who might be able to defeat or frustrate the purpose of the OCSLA by asserting state police and taxation powers to OCS activities.

States adjacent to the OCS had attempted to include language in the act that would have allowed them to collect severance and production taxes. 99 Cong. Rec. at 2569 (1953). Senator Long of Louisiana argued that adjacent states needed to share in OCS revenue because services adjacent states provided to OCS workers would necessarily be paid from state treasuries. Senator Long's arguments failed and the final version of the OCSLA included the language that "State taxation laws shall not apply to the Outer Continental Shelf".

Nothing in the OCSLA or its legislative history can be construed as prohibiting states, either adjacent or inland, from fairly apportioning on income derived from sales in the taxing state. This is true even if the state's apportionment scheme indirectly results in taxation of income earned on the Outer Continental Shelf. What the OCSLA prohibits is an adjacent state (or states) enacting a severance, production or even an income tax on Shell Oils OCS operations. In other words, a coastal state cannot adopt Shell's separate accounting method for OCS "income" and then levy a tax on the entire amount, based upon some claim of territorial jurisdiction. However, the OCSLA does not prohibit the adjacent state from indirectly taxing some portion of OCS activities pursuant to a constitutionally permissible apportionment scheme related to Shell's sales in the taxing state. *Shell Oil Company v. Department of Revenue*, Nos. 66, 240 and 66, 254 (Fla. Sup. Ct., April, 1986).

As stated above, the OCSLA was primarily concerned with defining territorial jurisdiction and to quiet title as between adjacent states and the federal government as to

submerged lands. The OCSLA established boundary lines between state and federal domains. After enactment of the OCSLA, the OCS is clearly in the federal domain. 43 U.S.C. Section 1333(a)(3). Any taxation of the OCS by adjacent states would now be extraterritorial taxation, and it is extraterritorial taxation that is proscribed by the OCSLA. The issue then becomes whether Iowa's single factor apportionment scheme for unitary businesses results in extraterritorial taxation.

The Supreme Court has frequently considered whether state apportionment schemes result in constitutionally proscribed extraterritorial taxation. Most notably, the Court in *Moorman Manufacturing Company v. Bair*, 437 U.S. 267, 57 L.Ed. 2d 197, 98 S.Ct. 2340 (1978) upheld Iowa's single factor sales formula to apportion income. The Court held that Iowa's formula was reasonably related to Moorman's activities within the State of Iowa. The Court further held in *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 230, 65 L.Ed.2d 66, 100 S.Ct. 2109, 2123 (1980) that "that the geographic location of such raw materials (oil and gas) does not alter the fact that such income is part of a unitary business of the interstate enterprise and is subject to fair apportionment among all states to which there is a sufficient nexus with the business."

Shell contends that these cases are not instructive because they were decided on constitutional grounds, while Shell's OCS argument is based on statutory language. Even though the prohibition on state taxation of OCS activities is statutory, the OCSLA proscribes only extraterritorial taxation and is analogous to the constitutional proscription against extraterritorial taxation. Iowa's single factor sales formula does not result in extraterritorial taxation of income derived solely from Illinois operations. *Moorman, supra.* Likewise, Iowa's apportionment scheme does not tax income derived by Shell solely from the OCS. Rather, Iowa's indirect taxation of Shell's OCS income is directly attributable to Shell's sales within the State of Iowa.

Shell argues that the OCSLA's prohibition of state taxation was not meant to apply only to adjacent states and, even if Congress so intended, Congress could not have constitutionally denied adjacent states taxing powers that were allowed for interior states (Reply Brief of Petitioner, p. 21). Shell is correct in that the extraterritorial taxation proscribed by the OCSLA applies to all fifty states. As a practical matter, the prohibition on state taxation found in the OCSLA applies only to adjacent states. An inland state, such as Iowa, would appear rather foolish arguing that its territorial boundaries extend into the Atlantic or Pacific Ocean and that the state was not leasing submerged lands for oil and gas exploration, or, that it was imposing a severance tax on oil and gas removed from such territory. However, a coastal state, prior to the enactment of the OCSLA, could conceivably have made such a claim.

In short, the OCSLA prohibits extraterritorial taxation of the OCS by both inland and adjacent states. All states, inland or adjacent, are free to apply apportionment formulas which may indirectly tax OCS revenues, so long as the taxation is related to activities within the taxing state.

ADEQUACY OF NOTICE

Shell argues that the Department's June 10, 1982 Notice of Assessment of the years 1975, 1976 and 1977 was not timely. Therefore, Shell contends, the Department is precluded from assessing Shell with any additional tax liability.

Shell filed its 1975 Iowa tax return on October 28, 1976, filed its 1976 Iowa return on October 18, 1977 and filed its 1977 Iowa return on October 25, 1978 (Stip. par. 27). The assessment for additional Iowa income tax for

these years was issued by the Department on June 10, 1982 (Stip. par. 30).

Iowa Code Section 422.25(1) is applicable to this case. Section 422.25 was amended in 1981 in 1981 Iowa Acts, Ch. 135. 1981 Iowa Acts, Ch. 134, Section 2 provided that "this act is applicable for all tax years for which a final disposition of a taxpayer's federal income tax liability has not been resolved prior to the effective date of this act." Section 422.25(1) provides, in relevant part, as follows:

> 1. Within three years after the return is filed or within three years after the return became due, including any extensions of time for filing whichever time is the later, the department shall examine it and determine the correct amount of tax, and the amount determined by the department shall be the tax.
>
> . . .
>
> In addition to the applicable period of limitation for examination and determination, the department may make an examination and determination at any time within six months from the date of receipt by the department of written notice from the taxpayer and the internal revenue service with respect to the particular tax year.

Shell concedes that its federal tax return for 1975, 1976, and 1977 were the subject of a federal audit. (Stip. pars. 38-42). As of the date the Department's Notice of Assessment was sent to Shell, the dispute between Shell and the IRS for the returns in question had not been resolved (Stip. par. 41 and 42). Therefore, if the six month exception provided for in *Iowa Code* Section 422.25 applies, then the Department's Notice of Assessment to Shell was timely.

Shell argues that the six month exception of Section 422.25 does not apply where, as here, the Department's

assessment is not related to any adjustments made as a result of a federal audit. No such restriction is found in Section 422.25. The statutory language does not restrict the Department's audit of Shell's return to "federal" adjustments only.

The six month exception in Section 422.25 provides "In addition to the applicable period of limitation for examination and determination, the department may make an examination and determination at any time within six months . . . ." The "examination and determination" (or audit) referred to in the six month exception is the same "examination and determination" (or audit) which is allowed during the customary three year limitations period. There is no requirement in Section 422.25, as Shell contends, that the Department perform an initial audit of "state issues" during the three year limitations period and then perform a second audit or adjustment to the return after the federal audit is complete. The Court declines the invitation to impose a limitation period upon the Department that does not exist in the applicable statute.

ORDER

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the Final Order entered on August 26, 1985 by the hearing officer in the above entitled matter is affirmed. Costs are taxed to the petitioner.

Dated this 3rd day of October, 1986.

/s/Joel D. Novak
JOEL D. NOVAK,
Judge
Fifth Judicial District of Iowa

APPENDIX C

BEFORE THE IOWA DEPARTMENT OF REVENUE
HOOVER STATE OFFICE BUILDING
DES MOINES, IOWA

DOCKET NO. 82-157-2A-A

IN THE MATTER OF

SHELL OIL COMPANY
One Shell Plaza
P.O. Box 2463
Houston, Texas 77001

CORPORATE INCOME TAX ASSESSMENT

ORDER OF DIRECTOR UPON REVIEW OF HEARING OFFICER'S PROPOSED ORDER

On September 23, 1985, the Iowa Department of Revenue (Department) filed an appeal to the Director of the Iowa Department of Revenue (Director), appealing the portion of the Hearing Officer's Proposed Order of August 26, 1985, which deleted paragraphs 22, 23, 24, and portions of paragraph 25 of the parties' Stipulation. On September 24, 1985, Shell Oil Company (Protestor) filed an appeal of the Hearing Officer's Proposed Order.

On October 4, 1985, the Director issued a Notice of Director's Review of Hearing Officer's Proposed Order, setting a review date of November 4, 1985. On October

14, 1985, the parties filed a Joint Agreement and Statement of Protestor and Department of Revenue.

The Director, having examined the record developed by the parties, hereby issues this Order.

STATEMENT OF THE CASE

The Director hereby adopts and fully incorporates into this Order the Statement of the Case as set forth in the Hearing Officer's Proposed Order.

FINDINGS OF FACT

The Director hereby adopts and fully incorporates as Findings of Fact the parties' Stipulation in its entirety. In addition the Findings of Fact numbered 47 through 51 in the Hearing Officer's Proposed Order are adopted and fully incorporated herein.

CONCLUSIONS OF LAW

The Director hereby adopts and fully incorporates into this Order the Conclusions of Law as set forth in the Hearing Officer's Proposed Order.

SUMMARY

The Director hereby adopts and fully incorporates into this Order the Summary as set forth in the Hearing Officer's Proposed Order.

IT IS THEREFORE ORDERED that the assessment of corporate income tax, interest, and fees as set out in the Notice of Assessment dated June 10, 1982, is affirmed. The Protestor failed to meet its burden of proof on the issues raised. With respect to the record developed by the parties, the evidence is more than substantial to support the factual and legal conclusions of this Order.

The Director's decision is the final Order of the Iowa Department of Revenue.

Issued at Des Moines, Iowa, this 4th day of December, 1985.

IOWA DEPARTMENT OF REVENUE

By /s/ G. D. Bair
G. D. BAIR
Director

APPENDIX D

BEFORE THE IOWA DEPARTMENT OF REVENUE
HOOVER STATE OFFICE BUILDING
DES MOINES, IOWA

DOCKET NO. 82-157-2A-A

IN THE MATTER OF

SHELL OIL COMPANY
One Shell Plaza
P.O. Box 2463
Houston, Texas 77001

CORPORATE INCOME TAX ASSESSMENT

PROPOSED ORDER

Pursuant to order of the undersigned Hearing Officer, this matter came on for evidentiary hearing before Orville Caruthers, Hearing Officer for the Iowa Department of Revenue, on December 12, 1984. Present at the hearing were James W. Hall, Attorney at Law and authorized representative for Shell Oil Company (hereinafter called "Protestor" or "Shell"); Thomas G. Singley, Assistant General Tax Counsel for Protestor; William D. Peltz, Senior Tax Counsel for Protestor; and Harry M. Griger, Special Assistant Attorney General for the State of Iowa and authorized representative for the Iowa Department of Revenue (hereinafter called the "Department"). The evidentiary hearing was reported by certified shorthand reporter Jill D. Stump.

STATEMENT OF THE CASE

The Protestor filed a protest in this matter on September 7, 1982, protesting the assessment of additional corporate income tax against Protestor. The Department

filed an Answer to that protest on May 5, 1983. A hearing officer for the Department issued a Notice of Time, Place and Nature of Hearing scheduling an evidentiary hearing on October 4, 1983. The authorized representative for the Department filed a Request for Prehearing Conference on June 3, 1983. A hearing officer for the Department issued a Notice of Prehearing Conference on June 22, 1983, scheduling a prehearing conference on July 25, 1983. Subsequently, the hearing officer for the Department continued the prehearing conference to October 4, 1983, and continued the evidentiary hearing to December 6, 1983. On September 21, 1983, an order was entered indefinitely continuing the prehearing conference. On November 10, 1983, an order was entered rescheduling the evidentiary hearing on May 23, 1984. On May 18, 1984, an Order for Continuance was entered rescheduling the evidentiary hearing on July 10, 1984. On June 19, 1984, an Order of Continuance was entered rescheduling the evidentiary hearing on September 10, 1984. On September 5, 1984, an order was entered rescheduling the evidentiary hearing on October 30, 1984. On October 12, 1984, an Order for Continuance was entered rescheduling the evidentiary hearing on December 12, 1984.

Protestor filed a Motion for an Order of Deletion on December 11, 1984; a Motion For Supplemental Order Of Deletion on May 31, 1985; and a Renewed Motion For Supplemental Order Of Deletion on July 2, 1985. See paragraphs 49 and 50 of the Summary (page 51 of this Proposed Order) for the resulting deletion orders.

The Protestor offered the following exhibits in evidence and these were received in evidence without objection from the authorized representative for the Department:

Exhibit 9: A copy of one page entitled "Shell Oil Company Iowa" showing figures for 1975 through 1980 for sales, payroll and property.

Exhibit 10: A copy of the Notice of Assessment issued to Shell Oil Company for corporation income tax for the years 1975 through 1980, bearing notice date of June 10, 1982.

Exhibit 11: An affidavit by Mason J. Neville consisting of three pages and dated December 7, 1984.

Exhibit 12: An affidavit of Steven C. Stryker consisting of eight pages, dated December 10, 1984.

At the evidentiary hearing on December 12, 1984, the following was offered as a supplement to Exhibit 12:

Mr. Stryker, the affiant in Exhibit 12, is a graduate of the University of Iowa. He graduated in 1967 with a bachelor's of science degree in sociology. He graduated from Iowa Law School in 1969 with a J.D. degree. He is a graduate of Northwestern University Graduate School of Business and received a certificate of professional accounting in 1969.

He became a CPA in Illinois in 1971 and was licensed as a Certified Public Accountant in Iowa in 1972. From 1968 through 1972 Mr. Stryker was employed by Arthur Young and Company as a senior tax accountant. From 1972 through 1973 he was employed by Massey-Ferguson in Des Moines. He was manager of Federal income tax, North American operations.

From 1973 through 1978 he worked for FMC and was manager of Federal and State taxes. From 1978 to the present he has been employed by Shell Oil Company in Houston. He is the general manager and assistant general tax counsel.

He is a member of the American Petroleum Institute and the Tax Executives Institute. He is a member of the American Bar Association. He is a member of the American Institute of Certified Pub-

lic Accountants. He is a member of the Iowa State Bar Association and a member of the Iowa Society of CPAs.

The Protestor offered the following Exhibits 1 through 8 and 13 in evidence. The Department objected to the reception of these nine exhibits in evidence on the grounds of relevancy. Based on the objection to "relevancy" without any further explanation or argument in support of the objection, and upon examination of Exhibits 1 through 8, the Hearing Officer concludes that he cannot determine, as of the time of submission of the case to the hearing officer, that all of Exhibits 1 through 8 are irrelevant to all of the issues in this matter, therefore, the objection as to Exhibits 1 through 8 is overruled and Exhibits 1 through 8 are received in evidence. Upon examination of Exhibit 13, the Hearing Officer comes to the same conclusion as on Exhibits 1 through 8 and, therefore, Exhibit 13 is received in evidence:

Exhibit 1: A copy of Shell Oil Company Exploration and Production Schedule E for 1975.

Exhibit 2: A copy of Shell Oil Company Exploration and Production Schedule E for 1976.

Exhibit 3: A copy of Shell Oil Company Exploration and Production Schedule E for 1977.

Exhibit 4: A copy of Shell Oil Company Exploration and Production Schedule E for 1978.

Exhibit 5: A copy of Shell Oil Company Exploration and Production Schedule E for 1979.

Exhibit 6: A copy of Shell Oil Company Exploration and Production Schedule E for 1980.

Exhibit 7: Consists of 12 pages entitled "Shell Oil Company Iowa Income Tax" for the years 1975 through 1980.

Exhibit 8: A copy of one page entitled "Shell Oil Company Iowa Income Tax Audit 1975-1980."

Exhibit 13: A copy of five pages of data making comparison with a cited case, with a "Iowa computation" and "Iowa income tax."

The following Exhibits were offered in evidenced by the Department and these were received in evidence without objection from the Protestor:

Exhibit A: A copy of form 10-K filed by Protestor for 1975.

Exhibit B: A copy of form 10-K filed by Protestor for 1976.

Exhibit C: A copy of form 10-K filed by Protestor for 1977.

Exhibit D: A copy of form 10-K filed by Protestor for 1978.

Exhibit E: A copy of form 10-K filed by Protestor for 1979.

Exhibit F: A copy of form 10-K filed by Protestor for 1980.

Exhibit G: A copy of the Corporation Income Tax Return for the State of Iowa filed by Protestor for the year 1975.

Exhibit H: A copy of the Corporation Income Tax Return for the State of Iowa filed by Protestor for the year 1976.

Exhibit I: A copy of the Iowa Corporation Income Tax Return and the Amended Iowa Corporation Income Tax Return filed by Protestor for 1977.

Exhibit J: A copy of the Iowa Corporation Income Tax Return filed by Protestor for 1978.

Exhibit K: A copy of the Iowa Corporation Income Tax Return filed by Protestor for 1979.

Exhibit L: A copy of the Iowa Corporation Income Tax Return filed by Protestor for 1980.

Exhibit N: An affidavit of John Christensen dated December 10, 1984, consisting of six pages.

Exhibit O: A copy of a Ruling on Special Appearance and Order, from the case of *Shell Oil Company v. G. D. Bair, Director, Iowa Department of Revenue*, no. CL04928706, in the Iowa District Court for Polk County.

Exhibit P: A copy of a Declaratory Ruling issued by the Department in the case of *In Re: The Petition of Shell Oil Company for a Declaratory Ruling on H.F. 2479*, bearing the Department's docket number 82-232-2A-DR, consisting of 13 pages.

The Department offered Exhibit M in evidence. The Protestor objected to the reception of Exhibit M in evidence on the grounds that it was irrelevant and on the further grounds that Exhibit M was written as a part of proposed settlement negotiations in a prior dispute of a similar nature and is therefore inadmissible into evidence in this case. The Department does not agree that Exhibit M was written as a part of any settlement negotiations and contends that an objection based on settlement negotiations is not grounds for exclusion of evidence under Iowa Code § 17A.14 and Department rule 730-7.17(2) IAC. Upon examination of Exhibit M, the Hearing Officer concludes that he cannot determine that all of Exhibit M is totally irrelevant. The Hearing Officer further concludes that the objection to Exhibit M on the grounds that it was written as a part of settlement negotiations is not a proper grounds for exclusion of evidence under the statute and rule cited by the Department. The following Exhibit M is received in evidence:

Exhibit M: A copy of a two-page letter from Protestor to the Department, dated September 10, 1980.

At the conclusion of the evidentiary hearing on December 12, 1984, the parties and the Hearing Officer agreed upon a briefing schedule. The Protestor was to file its brief within 60 days after the transcript was finished; the Department was to file its brief within 60 days after receipt of Protestor's brief; and the Protestor was to file its reply brief within 30 days following receipt of the Department's brief. An extension of time was granted to the parties and the Protestor's final brief was filed with the Department on July 2, 1985; the case was deemed submitted to the Hearing Officer for decision on that date.

FINDINGS OF FACT

The parties filed a *STIPULATION* in this matter on December 11, 1984. That stipulation provided that ". . . the following statements are made in lieu of oral testimony . . ." and ". . . either party may introduce other and further evidence not inconsistent with the facts herein stipulated . . .", therefore that *STIPULATION* is taken as a stipulation of testimony and evidence offered and not as a stipulation of facts to be incorporated in full. The *STIPULATION*, after deletions of non-factual material, arguments and controverted material, reads as follows and is adopted as a part of the Findings of Fact:

STIPULATION

IT IS HEREBY STIPULATED that for the purposes of this case the following statements are made in lieu of oral testimony and all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part thereof; provided, however, that either party may introduce other and further evidence not inconsistent with the facts herein stipulated and provided further that either party may object to statements and exhibits in this stipulation on grounds of relevancy.

STIPULATION

I

GENERAL DESCRIPTION OF SHELL OIL COMPANY

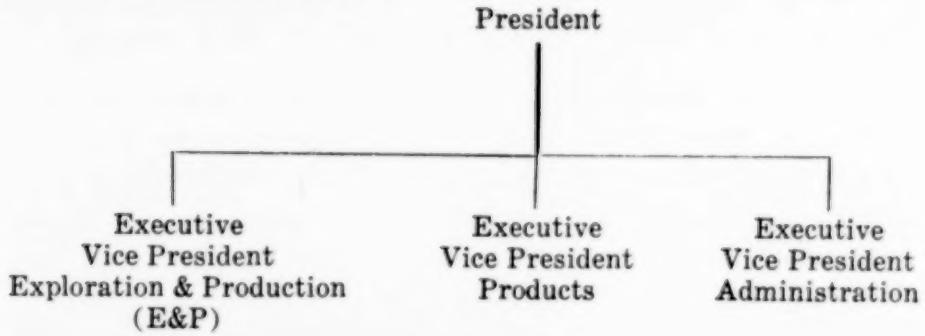
1. Shell Oil Company ("Shell") is a Delaware corporation with business operations in all fifty states and the District of Columbia.

2. During the years 1975 through 1980, Shell was the parent member of an affiliated group of corporations, the principal business of which is the exploration for, and development, production, transportation, purchase, and marketing of crude oil and natural gas, and the purchase, manufacture, and marketing of oil and chemical products. Shell is a vertically integrated oil company which itself engages in the business activities set out above and also set forth in paragraph 4(b)(1) of the Protest and in Shell's annual 10K reports, Exhibits A, B, C, D, E, and F.

3. During the years 1975 through 1980 Shell Oil Company conducted the majority of its business activities as two separate operating organizations, the Products Organization and the Exploration and Production (E&P) Organization. Management was headed by a President. The President is the Chief Executive Officer of the Company with responsibility for the general and active supervision and management of the property, affairs, and business of the Company. There are three Executive Vice Presidents. Two of them are responsible to the President for their respective operating organizations, the Products Organization and the E&P Organization; the third Executive Vice President is responsible to the President for the staff organizations such as Legal, Tax, Finance, Employee Relations, and administers those functions as they apply to the other two organizations (E&P and Products). The E&P Organization is responsible for locating and acquiring rights to develop and produce crude oil, gas,

and other natural resources. The production resulting from the E&P Organization's activities is Shell's major single supply of raw material. The Products Organization is responsible for the transportation, purchasing, and marketing of crude oil and natural gas liquids, and the manufacture and marketing of petroleum and chemical products. The Products Organization's products are refined and manufactured from feedstock (crude oil and natural gas) obtained from the E&P Organization or purchased from others. The Products Organization does not perform any functions on the Outer Continental Shelf (OCS).

The following is a diagram of the just-described portion of Shell's management which is located at Shell's offices in Houston, Texas.



4. The Products Organization has two major operating segments; Oil Products and Chemical Products; it is headed by an Executive Vice President. The Oil and the Chemical segments are each managed by a Vice President who has overall management responsibility for his business line and its sales function. There are three other segments of the Products Organization, the Operations and Technical segments which perform support functions; and the Special Projects segment which is responsible for special ventures involving the manufacture of selected petrochemical products in world-scale quantities. The Products Organization obtains part of its crude oil requirements from Shell's E&P Organization.

During 1975-80, for purposes of accounting for the transfers of crude oil production from Shell's E&P Organization to Shell's Products Organization, the transfers were recorded by Shell as sales at posted industry prices with appropriate adjustments for gravity * and transportation, but no money was paid for such intracompany transfers. Such transfers at posted industry prices involved crude oil production in the OCS and non-OCS areas. See paragraph 23, *infra*. During the years 1975 through 1980 Shell was a "net purchaser" of crude oil, its E&P Organization provided from a low of 48.6 percent of the Products Organization's crude oil in 1977 to a high of 60.7 percent in 1980. The balance of Shell's crude oil requirements was acquired by way of purchase by the Products Organization. Such purchases included purchases from domestic sources (including purchases from other OCS producers) and from foreign sources.

5. The E&P Organization has three operating segments; Domestic, International and Mining. During the years at issue the domestic oil and gas segment was divided geographically between Western Operations and Eastern Operations and contained five divisions. The Offshore Division was one of the five divisions and was part of Eastern Operations and it was through the Offshore Division that Shell's Outer Continental Shelf operations were conducted. One of the other four divisions was in Eastern Operations, the other three were in Western Operations; they had primary responsibility for exploration and production in non-OCS areas in the United States. The general manager of the Offshore Division and his staff located in New Orleans, Louisiana, conceived and executed operational plans and managed the existing

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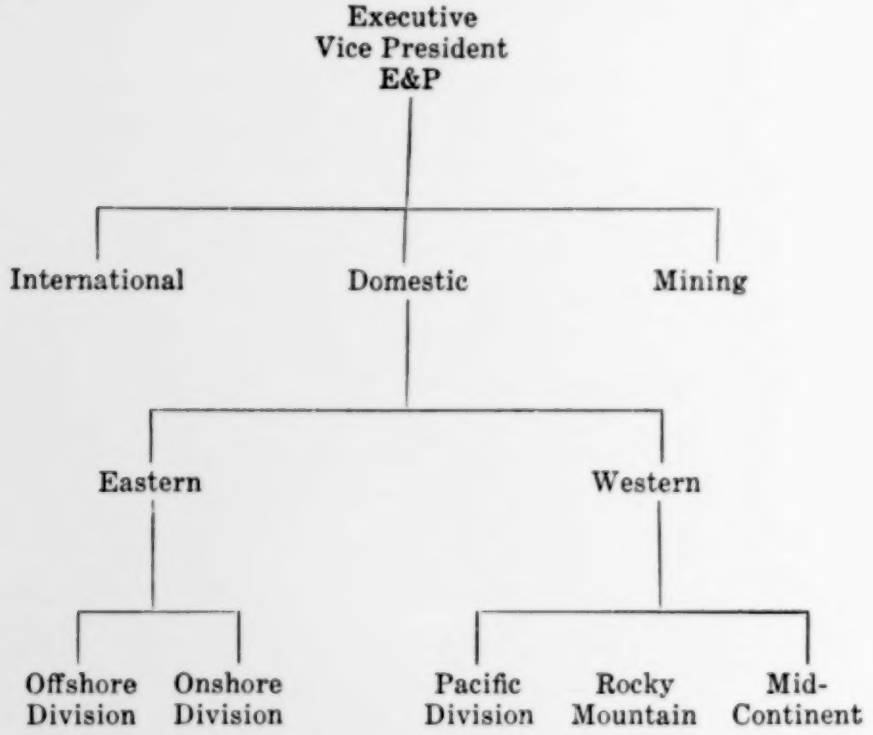
* Gravity of crude oil is measured on the A.P.I. (American Petroleum Institute) scale. The lighter in weight the oil, the greater the A.P.I. gravity. Most crude oils range from 27° to 35° A.P.I. Other factors being equal, the higher the A.P.I., the better price the oil will bring.

Shell assets on the Outer Continental Shelf (OCS). The general managers of the other divisions had similar responsibilities for, and exercised similar authority over, their respective divisions. The following is a diagram of the E&P Organization which represents the domestic segment.



The geographics areas covered by the various divisions were:

Offshore—Outer Continental Shelf;

Onshore—Connecticut
Delaware
Florida
Louisiana
Maine
Massachusetts
New Hampshire
New Jersey

Rhode Island
South Carolina
Vermont

Alabama, Southern 1/2
Arkansas, Southern 1/2
Georgia, except Northwest corner
Maryland, except Western panhandle
Mississippi, except Northeast corner
New York, Southern tip and Long Island only
North Carolina, Eastern 2/3
Pennsylvania, Southeast corner
Texas, South and East Texas
Virginia, East of Appalachians

Mid-Continent—Illinois
Indiana
Iowa
Kansas
Kentucky
Michigan
Minnesota
Missouri
Ohio
Oklahoma
Tennessee
West Virginia
Wisconsin

Alabama, Northern 1/2
Arkansas, Northern 1/2
Colorado, Southeast corner
Georgia, Northwest corner
Maryland, Western panhandle
Mississippi, Northeast corner
Nebraska, except Western portion
New Mexico, Southeastern 2/3

New York, except Southern tip and Long Island
North Carolina, Western 1/3
Pennsylvania, except Southeast corner
Texas, North and West Texas
Virginia, Western edge

Rocky Mountain—Arizona
Idaho
Montana
Nevada
North Dakota
South Dakota
Utah
Wyoming

Colorado, except Southeast corner
Nebraska, Western Portion
New Mexico, Northwestern 1/3
Oregon, except Western coastal region
Washington, except Western coastal region

Pacific—Alaska
California

Oregon, Western coastal region only
Washington, Western coastal region only

The division's boundaries were determined principally by geographic and geological features rather than by state boundary lines.

6. During 1975-80, within the State of Iowa, Shell's principal business consisted of marketing oil and chemical products refined and manufactured by the Products Organization. There were crude oil based Shell-manufactured products sold in Iowa which were manufactured from crude oil which was commingled to the extent that the ultimate source (OCS or non-OCS) of the crude oil could not be determined with any degree of certainty. All of Shell's activity in Iowa was of such a nature that

it fell within the purview of the Executive Vice President—Products. See paragraph 3, above.

7. Shell's activities as described in paragraph 2 of this Stipulation, including its activities on the OCS, constitute a unitary business, a portion of which, as stated in paragraph 6, was carried on within the state of Iowa during the years 1975 through 1980. Shell's activities are substantially similar to those described in the case of *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980).

II

OUTER CONTINENTAL SHELF OPERATIONS

AREA INVOLVED

8. Under the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1331, *et seq.*, the Outer Continental Shelf (OCS) is defined as "all submerged lands lying seaward and outside the area of lands beneath navigable waters as defined in section 1301 of this title, and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control." 43 U.S.C. 1331(a). Section 1301 of title 43 U.S.C. is part of the Submerged Lands Act (43 U.S.C. 1301 et seq.) and defines "land beneath navigable waters" as essentially that area within three miles of the coast line of the United States. (Texas owns 3 marine leagues into the Gulf of Mexico.) In short, the Outer Continental Shelf is the submerged land, as defined in 43 U.S.C. § 1331(a), which lies beyond the 3-mile limit. Rather than being a geographic feature, as would be inferred from its name, the OCS is a legal term describing the land extending seaward from a state's offshore boundary under water over which the United States claims economic or territorial jurisdiction. As such the OCS is not located in the State of Iowa or any other of the 50 states, so during 1975 through 1980 the actual extraction of OCS minerals did not occur in Iowa or any of the other 50 states. The

OCS surrounds the continental 48 states, Alaska and Hawaii.

9. The rights to explore for, develop and produce hydrocarbons (oil and gas) from beneath the OCS were conveyed by the federal government to private enterprises by way of lease sales. During the years at issue specific tracts of OCS land were selected to be the subjects of lease sales. The size of these tracts ranged from 750,000 to 1 million acres and the leases were usually in 5,000 or 5,760 acre blocks. The lease sale was advertised in the Federal Register at least 30 days before the sale with the sale date, place and time, the tracts to be offered, and the royalty amount (usually 1/6) set by the government.

Pursuant to the terms of the sale, sealed bids were submitted. Prospective bidders could bid alone or in conjunction with others. An amount equal to 20% of the bid price had to be submitted with the bid and all of the procedural requirements of the bidding procedure had to be observed. Leases went to the highest bidder, but a property might not be awarded to the highest bidder if the bid price was less than what the government considered a fair price for the area. If all bids were rejected on an area, that area was usually open for bidding in the next lease sale. On a successful bid it could take up to 30 days to announce whether the tract had been awarded, but the announcements usually followed within two weeks of the opening of bids. Thereafter, the winning bidder had 30 days to submit the 80% of the bid price not deposited with the bid along with the first years' rent.

The successful bidder received an oil and gas lease pursuant to the terms advertised in the announcement of the sale. Generally, the terms of the lease provided for a 1/6 royalty and gave the successful bidder the exclusive right to explore, develop, and produce petroleum from beneath the area awarded. The initial term (that time period during which actual extraction of gas or oil

must begin) was usually five years. There was generally a rental provision of $3 per acre per year. Rent was to be paid each year in advance during the initial five year period or until the start of production; after production started the rent would be paid in the form of a royalty based on production.

The term of the lease was to run for as long as there was production; absent production the lease would expire at the end of the five year initial term. The lease would of course terminate on abandonment or surrender by the leasee. Upon termination of the lease for any reason, the structures built thereon were to be removed and any wells to be plugged and abandoned in accordance with government regulations.

The leasing procedure for OCS leases is different from onshore leasing procedure. On land large lease areas can be acquired only where there are large individual or corporate landowners or where a number of smaller parcels of land can be assembled. In the face of competition for mineral properties it is extremely difficult to assemble a large block of small lease areas. On land the terms of the lease will vary depending on the bargaining positions of the parties, and allowable time prior to production usually will be shorter than that allowed for OCS leases.

Shell has onshore leases or owns land from which it extracts oil and gas and which is not part of the OCS.[1] Shell was and is constantly exploring for oil and gas in non-OCS areas.

EXPLORATION

10. The following description sets out Shell's activities pursuant to the OCS leasing procedures in effect during the years at issue. These leasing procedures pertain to Shell's leasing of mineral rights on government lands in the OCS from the Federal government. The Offshore Division's (Offshore) activities with respect to an offshore

lease usually commenced with a response to a government call for information regarding tracts set out in the Government's plan for leasing in a specific geographic area. The call for information usually occurred about two years before the tracts in question were to be the subject of a lease sale. The response to the call for information was an outline of a large general area of interest that Offshore would like to see come up for sale. Prior to the initiation of area-wide offshore sales in 1983, each prospective bidder would nominate individual tracts and only those tracts that received more than one nomination were put up for sale. In area-wide sales all the tracts in a defined area are put up for sale so a bidder does not have to wait until at least one other bidder also recognizes the hydrocarbon potential under a tract before it is put up for lease. In the years at issue (1975-80) the areas of interest were identified by actual lease block and by relative degree of desirability of the area; present practice is to describe the areas of interest by general geographic location.

11. Prior to the call for information, Offshore geophysicists would work up potential prospects using the existing seismic data relating to the general region of interest. The existing data may have contained seismic information generated in the course of Offshore's prior activities in the general area and information purchased from others engaged in commercial seismology. In addition, geophysicists would generate further seismic data in an attempt to locate geologic structures favorable to the accumulation of hydrocarbons. The additional seismic data was acquired by specially equipped ships towing an air gun which is used to "shoot" in the areas of interest. "Shooting" consists of systematically transmitting pulses of energy (analogous to sound waves) and receiving reflected or refracted waves from the rocks below the seabed. [This differs from onshore 'shooting' in that on land the pulses of energy may be transmitted directly to the

land with a device that delivers a shock to the earth's surface in the manner of a hammer, or dynamite may be used to generate the energy pulse.] Normally a one-mile grid of seismic data or profiles is obtained over the area of interest while sweeping a series of parallel lines, or lanes, in a shipborne seismic survey. The seismic profiles generated enable geologists and geophysicists, 1) to obtain a subsurface map of the geological structures, if any, underlying the area of activity, and 2) to project the distribution of sands (reservoir rock) from previous wells, if any, drilled nearby.

12. The foregoing activities were completed by approximately one year before the area of interest was planned to be the subject of a lease sale. About one year prior to the lease sale, when the sale areas were announced, the activity narrowed to the announced sale areas, and more geologic and seismic data was collected to narrow the search even further. By approximately six months prior to a planned lease sale the manpower and effort devoted to the study of specific areas or tracts increased and the number of areas which are the subject of the study decreased so that there was a greater concentration effort. The effort was principally in two areas, geologic and seismic. The geologic study dealt with defining the character of the reservoir rock; and the seismic study dealt with the determination of the characteristics of the reservoir and defining the overall reservoir structure and its complexities.

13. After the geologic and seismic data had been gathered, Offshore conducted review processes to determine which of the lease sale tracts was most promising for development and production. The potential net feet of hydrocarbons, productive area, type of hydrocarbons anticipated (oil, gas or both), recovery factors and probability of success went into calculating minimum, mean and maximum hydrocarbon volumes. These volumes along with economic considerations, such as wildcat costs

and development costs went into determining which leases would be bid on by Shell.

14. After a successful bid on a lease, the lease was put into Offshore's drilling schedule on a priority basis consistent with other demands on the available money and equipment. A primary term on a lease was usually five years; so at least one well was drilled in that period of time. Since there will have been no prior production from the lease area, the first well drilled was referred to as a "wildcat" well and was drilled for the purpose of determining if there was an economic quantity of hydrocarbons on the lease.

15. Wildcat wells are usually drilled from one of three types of equipment. If the well is to be drilled in 250 feet or less of water then what is referred to as a jack-up rig is used. That is, a watertight hull and platform with vertically adjustable legs is floated to the drill site; the legs are lowered until they rest on the seabed; and drilling operations are conducted from the platform. Most offshore wells are drilled with a jack-up type rig since most wells are drilled in less than 250 feet of water depth. The use of a jack-up rig could cost from $15,000 to $40,000 per day.

16. If the well is to be drilled in water between 250 feet and 3,000 feet deep then a semisubmersible rig is used for the drilling operations. A semisubmersible rig has a working deck similar to a jack-up rig, but it is stabilized by ballasting its pontoons and columns to a predetermined depth; anchor cables or thrusters keep the platform properly located for drilling. For wells drilled in water in excess of 3,000 feet, a drill ship is the normal mode of drilling. The use of a drill ship could cost about $250,000 per day. The actual cost of drilling a well depends on the depth to which the well is to be drilled and the cost of the rig used. Thus the cost of a wildcat well ranges from $1 million for a 6000 foot test to $15 mil-

lion for a 20,000 foot test in less than 250 feet of water. However, for a drill ship the costs could be ten times as high for equivalent depths below the sea floor.

17. If a wildcat well is successful there is often more seismic data gathered including velocity surveys. With the new data the reservoir structure is remapped. Although the seismic data acquired after the drilling of a successful wildcat well is gathered by the exploration department it is done after the well has been transferred from the exploration department to the production department both of which are in the Offshore Division of the E&P Organization. The gathering of seismic data is done by the exploration department because it has the necessary equipment and experience to do so.

PRODUCTION

18. After the potential rate of production and the potential recoverable reserves are determined, detailed engineering studies are conducted and plans are made toward the end of proposing a development program for the lease. If the program is adopted, Offshore enters into a contract to build a platform. The platform is fabricated and installed within a period of approximately six months if the property is in shallow water; a deep water project may take as long as two to three years. The average time to fabricate and install a platform is in a range of 12 to 18 months. A platform for the purpose for developing a lease may cost anywhere from $1.5 million for a platform to be used in ten feet of water to $12 million for a platform to be used in 285 feet of water and in the hundreds of millions of dollars for a platform to be used in 800 feet of water.

The OCS development procedures and costs are radically different from those practiced on land. For example, offshore operations may require that several wells that could be produced from be plugged and abandoned prior to finding the optimum placement for a platform from which the lease may be fully developed. On land

there is no physical constraint that the property be developed from a relatively small area such as a platform; so wells may be drilled on 40 acre, 160 acre, or 640 acre spacing. The cost of drilling is also dramatically different. On land one might expect to encounter costs as follows:

Depth of Well	Cost
5,000 ft.	$300,000-400,000
10,000 ft.	$750,000-1 million
15,000 ft.	$2 million

19. No production wells in the OCS are drilled prior to the installation of a platform; however, some of the exploration wells drilled in shallow water may be used for production as the property is developed. After the drill rig is installed on the platform the drilling operations begin. An 8 or 9 thousand foot well may take approximately 15 days to drill while a 17,000 foot well would take approximately 120 days. If the drilling is done in an oil field there will be production while other wells are being drilled. That is, after the first well is drilled production casing and the other equipment necessary for production will be installed, and production will start from that well. Thereafter a second well will be drilled and production equipment will be installed. Following the same pattern a third and fourth well will be drilled until the planned number of wells is completed. If the wells are being drilled in a gas field then for safety reasons all of the wells that are planned will be drilled and cased without production taking place during the drilling activity. Then the other necessary equipment is put in place to bring the wells into production.

20. The equipment necessary to the operation of a production well includes separators, water treatment facilities, test facilities, compressors, and metering equipment. Because the fluids recovered from a well are often

a complex mixture of oil, gas, and water, they must be separated into their components and treated to obtain a pipeline quality product. Several stages of separators may be used to separate the oil, gas, and the other components of the well fluid. The oil is treated sufficiently to obtain a quality acceptable to the pipeline operator servicing the platform. Similarly, the gas is treated until it is acceptable to the gas collection pipeline operator servicing the platform. Compressors are used to deliver the product to the pipeline at the proper pressure. The well fluids left after the separation of the gas and oil (mostly water) are run through water treatment facilities in the OCS until they meet the environmental standards required for their return to the sea.

The equipment necessary for the recovery of oil and gas offshore is substantially different from the equipment used onshore. The difference is such that down-hole and well-head equipment is not interchangeable between onshore and offshore applications. There are also substantial differences between surface (above-ground) and platform equipment. The safety features and the size and configuration requirements imposed by operation on an offshore platform make it so difficult to use onshore equipment on a platform that such an occurrence would be extremely rare; and the added expense of equipment designed for offshore platform use precludes its use for onshore operations.

21. Test facilities are maintained in the OCS to ensure the quality of the crude oil delivered to the pipeline operator. And, of course, metering facilities are necessary to determine how much product is delivered to the pipeline operator. The pipeline servicing the platform may be owned by Shell or owned by an independent third party. Once the crude oil is in the pipeline it is transported to shore (continental United States) for delivery to a refinery or other manufacturing facility of either Shell or an unrelated refiner or manufacturer. The refined and manufactured products are marketed throughout the world. Most, but not all, of the crude oil extracted by Shell from the OCS wells was brought from the OCS to the continental United States. This crude oil was either refined in Shell's refineries in the continental United States, or was exchanged by Shell with other oil companies. The portion of that crude oil which was refined was either sold or exchanged. These exchanges were with other companies in the Petro-Chemical industry.

As is done with respect to crude oil, test facilities are maintained on the OCS to ensure the quality of a natural gas delivered to the pipeline operator, and metering equipment is used to measure the amount of natural gas transferred. All of Shell's OCS natural gas production is sold to pipeline companies at the producing platform on the OCS.

25. . . .

Shell files tax returns with every state (45 states and the District of Columbia) that has an income tax or a franchise tax measured by income. With the exception of Mississippi, Oklahoma, Alaska (for 1978-81), Iowa (for 1977-80) and Florida, Shell apportioned its net income to all other states (without deduction of its separately-computed OCS net income, all as computed by Shell pursuant to the procedures in Exhibit 7) on the basis of a three-factor formula. Shell, in filing state income tax returns, has never excluded its total OCS value of production from the pre-apportionment net income base pursuant to the procedures in Exhibit 7. Shell's factors for use in the three-factor formula in the years at issue are set out in Exhibit 9, attached hereto. Had Shell deducted its separately-computed OCS net income in the just-stated computation, Shell would have paid less tax in each of those states in each of the years at issue with the exception of 1978. [In 1978 the effect of the

reduction of apportionable income by the amount of OCS net income would not have offset the increase in apportionable income caused by the increase in the apportionment formula percentage due to the removal of OCS property, payroll and sales from the apportionment factors.] Had Shell deducted its total OCS value of production it would have paid less tax in every year.

III

JURISDICTIONAL AND STATUTE OF LIMITATIONS FACTS

26. Shell keeps its books and records on the accrual method of accounting and its income is reported on a calendar year basis.

27. Shell timely filed Iowa Corporation Income Tax Returns, Forms IA 1120, for the years in issue as follows in accordance with extensions to file procured pursuant to Iowa Code sections 422.21 and 422.38:

Taxable Year	Date Filed
1975	October 28, 1976
1976	October 18, 1977
1977	October 25, 1978
1977 amended	March 12, 1980
1978	October 30, 1979
1979	October 23, 1980
1980	October 27, 1981

28. During the period March 8, 1982, through approximately March 12, 1982, the Iowa Department of Revenue ("Department"), by and through its auditors, conducted a field audit of Shell's corporate income tax returns relating to calendar years 1975-80 inclusive.

29. On or about April 19, 1982, Shell received an unsigned document designated Notice of Adjustment and Deficiency For Corporation Income Tax, Form No. 96-

051 (Notice of Adjustment). The Notice of Adjustment was dated April 15, 1982, and bore the account number 000007975003. The Notice of Adjustment reflected proposed additional tax amounts due or (refund due) as follows:

Taxable Year	Tax
1975	$ 143,345.90
1976	204,941.00
1977	43,129.46
1978	8,755.20
1979	(117,024.70)
1980	(40,110.50)
Total	$ 243,036.36

The above amounts are exclusive of interest.

30. Attached hereto as Exhibit 10 is a copy of the Notice Of Assessment For Corporation Income Tax, Form No. 96-052 (Notice of Assessment), dated June 10, 1982, which was received by Shell on or about June 14, 1982. The Notice of Assessment reflected additional Tax Amounts due for the periods 1975 through 1980 identical to those set out on the Notice of Adjustment referenced in paragraph (27) above.

31. On September 1, 1982, within the lawful 90 day period following the Department's issuance of the Notice of Assessment referenced in paragraph (28) above, Shell filed a written protest pursuant to Sections 422.28 and 422.41 of the Iowa Code setting forth its specific objections to the assessment.

32. The audit adjustments underlying the Department's assessment notification relate to the Department's interpretation of Iowa statutes, regulations and case law. None of the adjustments which are the subject of the assessment and this contested case proceeding are the

result of any adjustment made in any audit by the Internal Revenue Service for any taxable year.

33. Shell and the Department have not entered into any waiver agreement authorized by Iowa Code section 422.25(7).

34. The amount in controversy for each taxable year, to the parties' knowledge, does not fall within those items of gross income defined in the Internal Revenue Code of 1954, as amended, as will under that Code extend the statute of Limitations for Federal tax purposes to six years, as set forth in Iowa Code section 422.25(1). Accordingly, to the parties' knowledge Shell's returns for years 1975, 1976 and 1977 could not be examined by the Department on the basis of a six year Statute of Limitations in section 422.25(1) commencing from the time each such return was filed or became due, whichever time is later.

35. The amount in controversy for each taxable year is not, to the parties' knowledge derived from false or fraudulent returns made with the intent to evade tax.

36. The amount in controversy for each taxable year was not assessed because of either the carryback of net operating losses or of net capital losses. Shell had overpaid its estimated Iowa income taxes for 1979 and 1980.

37. Shell has not at any time relevant herein forwarded to the Iowa Department of Revenue a written notification concerning the final disposition of any matter or controversy existing between it and the Internal Revenue Service (IRS) with respect to any of the years in question, 1975-1977 inclusive. In addition, Shell has not sent to the Department a copy of any Federal document purporting to show the final disposition or final Federal adjustments for any of the years in question, 1975-1977 inclusive.

38. By execution of IRS Forms 872, the limitation of time for the assessment of any deficiency in Shell's reported liability for Federal income tax for the year 1975 was extended to March 31, 1980.

39. In March 27, 1980, Shell received a statutory notice of deficiency dated March 25, 1980, with respect to Shell's Federal income tax liability for 1975. This statutory notice of deficiency arose out of an audit by the IRS of Shell's 1975 Federal income tax return. The IRS made purported adjustments to Shell's Federal taxable income.

40. On August 11, 1980, Shell paid the liability stated on the March 25, 1980, Notice Of Deficiency.

41. On February 23, 1981, Shell filed a claim for refund of the amount paid on August 11, 1980. As of the date that this stipulation is filed no final decision has been made by the IRS regarding that claim for refund.

42. On December 28, 1981, the IRS sent Notices Of Deficiency to Shell setting out deficiencies in Shell's Federal income tax for the years 1976 and 1977. On or about March 26, 1982, Shell filed a petition in the United States Tax Court (Docket No. 6784-82) for a redetermination of the deficiencies set forth in those Notices Of Deficiency; the petition also claimed refunds for the years 1976 and 1977. As of even date no decision has been entered in that case. This statutory notice of deficiency arose out of an audit by the IRS of Shell's 1976 and 1977 Federal income tax returns. The IRS made purported adjustments to Shell's federal taxable income for years 1976 and 1977.

IV

THE ISSUES

43. Whether the Department of Revenue notice of assessment of June 10, 1982 (Exhibit 10), would result in the taxation of any revenues or any of the net income de-

rived by Shell from the OCS and, if so, whether that is in violation of the Outer Continental Shelf Lands Act (43 U.S.C. § 1331 *et. seq.*), and/or the Supremacy Clause of the United States Constitution (U.S. Const. Art. VI, cl. 2), and the case law applicable thereto.

44. Whether the Department of Revenue was required to make its assessment for the years 1975, 1976, and 1977 of additional tax against Shell reflected by the June 10, 1982, assessment (Exhibit 10) when the assessment was not based upon federal audit adjustments to federal taxable income within three years after Shell filed its Iowa Income Tax Returns for the years 1975, 1976 and 1977.

45. Whether, if Shell is entitled to exclude total OCS revenues from its pre-apportionment net income base as computed in Exhibit 7, pages 1-6, Shell is barred from claiming refunds for 1975-80 by reason of § 422.73 of the Iowa Code.

46. The parties agree that the issues, as stated above, shall take precedence over the framing of the issues by the Hearing Officer in his Notice of Time, Place. and Nature of Hearing, dated May 16, 1983. The parties further agree that Shell's protest shall be deemed amended to be consistent with the facts and issues stated herein.

47. Pursuant to the provisions of Iowa Code § 17A.12 and Department rule 730-7.14 IAC, a Notice of Time, Place and Nature of Hearing was sent by certified mail to Protestor and Protestor's authorized representative on May 16, 1983. Protestor and Protestor's authorized representative claimed that mailed notice from the Postal Service on May 17 and May 19, 1983.

48. Exhibits 1 through 6 are accounting schedules prepared by Protestor which attempt to separate out parts of Protestor's unitary business. Exhibits 1 through

6 apply only to the OCS. Protestor does not, for Federal income tax purposes, compute a federal taxable income solely for the OCS, nor is Protestor required to do so. The amount of "Total Revenue" on the unnumbered line after line 11 on Exhibits 1 through 6 is the same amount appearing as "OCS Value of Production" and is the amount Protestor claims should be excluded from Protestor's preapportionment net income for purposes of computing Protestor's Iowa income tax liability.

49. Exhibits 7 and 8 are Protestor's internal accounting breakdowns of income and taxation for Protestor.

50. Exhibit 9 is an internal accounting summary of sales, payroll and property broken down by years for each of Iowa, OCS and everywhere else.

51. Exhibit 11 is an affidavit signed by Mason J. Nevill and the following paragraphs 1 through 5 of that affidavit are as follows:

My name is Mason J. Nevill. I am employed by Shell Oil Company (Shell). As Manager, Domestic Raw Materials Supply, I have as part of my overall responsibility the responsibility for the Management of Shell Oil Company's Crude Oil Gathering Systems on the Outer Continental Shelf (OCS). I have held that position from 1973 until the present time.

I make this Affidavit in support of Shell's protest in the above-captioned matter. The information hereinafter recited is within my personal knowledge and has been acquired by me during the course and within the scope of my employment with Shell.

During the years 1975-80 Shell owned and operated crude oil gathering systems (pipelines) on the Outer Continental Shelf. Those systems were used to transport crude oil from production platforms owned by Shell and others on the OCS to common carrier pipelines which

completed the transportation of the crude oil from the OCS to onshore distribution or processing points.

All of the crude oil transported in Shell's gathering system was owned or controlled by Shell at the time it entered the gathering system. Shell purchased or received on exchange the non-Shell produced crude oil prior to its entry into the Shell gathering system.

During 1975-80 the fees charged for the transportation of crude oil in Shell's gathering system were calculated to derive maximum economic benefit to Shell. However, due to government controls, fluctuations in production and unpredictable mechanical difficulties with the gathering system the net income earned by the gathering system varied from year to year.

CONCLUSIONS OF LAW

1. The Department has jurisdiction of this matter under the provisions of Iowa Code §§ 422.28 and 422.41.

2. It is incumbent upon a taxpayer contesting a Department action to show that the action was erroneous. *R. K. Richards v. the Iowa Department of Revenue*, 360 N.W.2d 830 (Iowa 1985); *Dain Mfg. Co. of Iowa v. Iowa State Tax Commission*, 22 N.W.2d 786 (Iowa 1946) and *City of Ames v. State Tax Commission*, 71 N.W.2d 15 (Iowa 1955).

FIRST ISSUE

3. The first issue is set out in paragraph 43 of the *STIPULATION* of the parties and that issue reads as follows:

> 43. Whether the Department of Revenue notice of assessment dated June 10, 1982 (Exhibit 10), would result in the taxation of any revenues or any of the net income derived by Shell from the OCS and, if so, whether that is in violation of the Outer Continental Shelf Lands Act (43 USC section 1331 et seq.),

> and/or the Supremacy Clause of the United States Constitution (U.S. Const., Art. VI, Cl. 2), and the case law applicable thereto.

4. The first question in the first issue is whether the Notice of Assessment (Exhibit 10) would result in the taxation of any revenues or any of the income derived by Shell from the outer continental shelf.

5. (See Stipulation, paragraph 8). Under the Outer Continental Shelf Lands Act, the outer continental shelf (hereinafter referred to as the "OCS") is defined as "all submerged lands lying seaward and outside the area of the lands beneath navigable waters as defined in section 1301 of this title and of which the subsoil and seabed appertain to the United States and are subject to jurisdiction and control." That act further defines "land beneath navigable waters" as essentially that area within three miles of the coastline of the United States. The OCS is not located within Iowa or within any other of the fifty states.

6. At all times pertinent to this matter, Iowa Code subsection 422.33 (1) read, in pertinent part, as follows:

> . . . . .
>
> 1. If the trade or business of the corporation is carried on entirely within the state, the tax shall be imposed on the entire net income, but if such trade or business is carried on partly within and partly without the state, the tax shall be imposed only on the portion of the net income reasonably attributable to the trade or business within the state, said net income attributable to the state to be determined as follows:
> b. . . . . .
>
> Where income is derived from the manufacture or sale of tangible personal property, the part thereof attributable to business within the state shall be in

that proportion which the gross sales made within the state bear to the total gross sales.

. . . . .

7. Protestor's business constituted a unitary business for the years 1975 through 1980. Protestor's income is derived from the sale of tangible personal property. The Department's Notice of Assessment was based on the apportionment formula set out in Iowa Code § 422.33(1)(b) (See the preceding paragraph 6).

8. In *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207, 65L.Ed.2d 66, 100 S. Ct. 2109 (1980), at L.Ed. 2nd p. 80, the Supreme Court stated that the taxpayer had the distinct burden of showing that a state was taxing extraterritorial values and that a taxpayer's internal accounting system was not sufficient to prove the correct allocation between states. The reasoning and conclusions reached by the court in that case apply to this matter. Also, see *Butler Brothers v. McColgan*, 315 U.S. 501, 86 L.Ed. 991, 62 S. Ct. 701 (1942) and *Mobil Corp., infra*, paragraph 10. Protestor's evidence of OCS "net income" or "revenue" (except for some sales of gas on the OCS) consisted of allocations to the OCS made by protestor's internal accounting assignments and calculations. Those internal accounting conclusions are not sufficient proof of OCS "net income" or "revenue".

9. Since the burden of proof is on Protestor, Protestor would have to prove that the Department Notice of Assessment would result in the taxation of OCS revenues or net income. Protestor did not prove that the Department was actually taxing OCS income. Protestor did not prove the amount of its Iowa profits or lack of profits.

10. In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 63L.Ed. 510, 100 S. St. 1223(1980), the Court was called upon to consider constitutional limitations on a nondomiciliary State's taxation of income received

from abroad by a corporation. At page 438 (445 U.S. 438) the Court stated:

> The argument that the source of the income precludes its taxability runs contrary to precedent. In the past, apportionability often has been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities formed part of a single unitary business. See Butler Bros. v. McColgan, 315 US 501, 506-508, 86 sL Ed 991, 62 S Ct 701 (1942); Ford Motor Co. v. Beauchamp, 308 US 331, 336, 84 L Ed 304, 60 S Ct 273 (1939); cf. Moorman Mfg. Co. v. Bair, 437 US, at 272, 57 L Ed 2d 197, 98 S Ct 2340. In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Butler Bros. v. McColgan, 315 US at 508-509, 86 L Ed 991, 62 S Ct 701. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source." Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required.
>
> The Court has applied the same rationale to businesses operating both here and abroad.

11. There is no recognized way that a unitary business can be accurately separated into separate enterprises for tax purposes. Any such separation would be, at best, an artificial, and not a real, separation. There

is no proof that the Notice of Assessment would result in the taxation of OCS "net income" or "revenues" and, therefore, there was no such taxation under the facts of this case.

12. The second question in the first issue (See paragraph 3 of these Conclusions of Law) is whether the use of the apportionment formula of Iowa Code Section 422.33(1)(b) is a violation of the OCSLA. Protestor's business is a unitary business and this question must be considered in the context of a unitary business and not as a theoretical question based on the theory that there is a theoretical "revenue" or theoretical "net income" "from the OCS."

13. In the case of *Continental Oil Company v. Federal Power Commission*, (1966) 370 F2d 57, 67, the court stated:

> "Congress passed the OCSLA solely to regulate the "leasing and development * * * of the oil potential of the Continental Shelf." H.R.Rep.No.413, 83d Cong., 1st Sess. 2-3 (1953), 2 U.S. Code Cong. & Ad.News p. 2178 (1953).

In the case of *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 69 L.Ed.2d 784, 101 S. Ct. 2870 (1981), at pages (453 U.S.) 480, footnote 7, reads as follows:

"The legislative history confirms that the purpose of OCSLA was 'to assert the exclusive jurisdiction and control of the Federal Government of the United States over the seabed and subsoil of the Outer Continental Shelf, and to provide for the development of its vast mineral resources. . . ."

14. The Protestor cites 43 USCS 1333(a)(2)(A) as supporting its position on the first issue and that section reads as follows:

> "(2)(A) To the extent that they are applicable and not inconsistent with this Act or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State now in effect or hereafter adopted, amended, or repealed are hereby declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward and defining each such area. All of such applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. State taxation laws shall not apply to the outer Continental Shelf."

15. 43 USCS 1353(a)(2)(A) uses the word "state" three times: First, as "adjacent State," then the second and third usages are simply "State." These usages are all concerning the application of an adjacent state's laws to the OCS, with the last sentence making that state's tax laws inapplicable to the OCS. All of those references to "State" concern the same subject—the application of the adjacent state's laws to the OCS. The Protestor has taken the last sentence of (a)(2)(A) out of context and is contending that the last sentence is a complete statement of general law by itself and should be read to mean that Protestor can carve out portions of a unitary business by internal accounting procedures and then the remainder can be apportioned under Iowa law. This hearing officer finds that all parts of 43 USCS 1333(a)(2)(A) should be construed together, that it all applies to adjacent States and not to Iowa.

16. The Protestor also cites 43 USCS 1333(a)(3) as supporting its position on the first issue. 43 USCS 1333(a)(3) reads as follows:

> "(3) The provisions of this section for adoption of State law as the law of the United States shall

> never be interpreted as a basis for claiming any interest in or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom."

As already determined, the adoption of State law in 43 USCS 1333(a)(2)(A), referred to in 43 USCS 1333(a)(3), refers to the adoption of an adjacent State's laws. The Department is not using *those sections* "as a basis for claiming any interest in . . . or the property and natural resources thereof or the revenues therefrom" under 43 USCS 1333(a)(3).

17. The hearing officer concludes that 43 USCS 1333(a)(2)(A) and 43USCS (a)(3) do not apply to the State of Iowa. The Protestor has failed to show that the intent of the OCSLA was to interfere with the unitary business body of law developed by the United States Supreme Court and other courts. The Protestor has failed to prove that the OCSLA prohibits the inclusion of Protestor's OCS business activities in the Iowa Code Section 422.33(1) apportionment formula.

18. A third question in the first issue is whether, under the Supremacy Clause of the United States Constitution, Iowa Code Section 422.33 is superseded by the Outer Continental Shelf Lands Act. Protestor seeks to have 43 USCS 1333(a)(2)(A) supersede Iowa Code Section 422.33. In *Subaqueous Exploration v. Unidentified, Wrecked Vessel*, U.S.D.C., District of Maryland (1983), 577 F.Supp. 597, 609, a case concerning the OCSLA, the court made this statement:

> "With respect to preemption and conflicts between state and federal laws, it is, of course, a fundamental principle of constitutional jurisprudence that the Supremacy Clause invalidates state laws that "interfere with, or are contrary to the laws of Congress . . ." Gibbons v. Ogden, 22 U.S. (9 Wheat.)1, 211,

> 63 L.Ed. 23 (1824). However, the "exercise of federal supremacy is not lightly to be presumed." New York Department of Social Services v. Dublino, 413 U.S. 405, 413, 93 S.Ct. 2507, 2513, 37 L.Ed.2d 688 (1973), quoting Schwartz v. Texas, 344 U.S. 199, 203, 73 S.Ct. 232, 235, 97 L.Ed. 231 (1952). "Preemption of state law by federal statute or regulation is not favored 'in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained.'" Alessi v. Taybestos-Manhattan, Inc., 451 U.S. 504, 522, 101 S.Ct. 1895, 1905, 68 L.Ed.2d 402 (1981), quoting Chicago & North Western Transportation Co. v. Kalo Brick & Telephone Co., 450 U.S. 311, 317, 101 S.Ct. 1124, 1130, 67 L.Ed.2d 258 (1981)."

In this matter, Protestor has not proven that Congress has unmistakably ordained that Iowa Code Section 422.33 should be superseded by 43 USCS 1333(a)(2)(A) and has not proven that "the nature of the regulated subject matter permits no other conclusion." Iowa Code Section 422.33 is not superseded by the OCSLA under the Supremacy Clause of the U.S. Constitution.

19. Protestor cited the case of *Maryland v. Louisiana*, 451 US 725, 68L.Ed.2d 576, 101 S. Ct. 2114 (1981) in support of its contention that Iowa Code Section 422.33 violated the Supremacy Clause by including OCS business activities in its formula. In *Maryland*, the State of Louisiana had imposed a "first use" tax on natural gas brought into Louisiana, whenever that gas had not been subjected to a severance tax outside Louisiana. That "first use" tax, then, applied mostly to OCS gas. That tax statute was set aside by the United States Supreme Court because it discriminated against interstate commerce in favor of local businesses and because a section of that tax statute violated the Supremacy Clause. Loui-

siana is an "adjacent State" (See 43USCS 1333(a)(2)(A)). A section of the Louisiana statute violated the Supremacy Clause, as it was found to conflict with the Natural Gas Act, ISUSC717, et seq., which was enacted "to assure that consumers of natural gas receive a fair price and also to protect against the economic power of the interstate pipelines." (68L.Ed, at page 596). *Maryland* quoted the following two standards to judge whether a state law violates the Supremacy Clause:

> (1) "Of course, a state statute is void to the extent it conflicts with a federal statute—if, for example, 'compliance with both federal and state regulations is a physical impossibility,' Florida Lime & Avocado Growers, Inc. v. Paul, 373 US 132, 142-143, 10 L Ed 2d 248, 83 S Ct 1210 (1963) . . ." and (2) ". . . where the law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" Hines v. Davidowitz, supra, at 67, 85 L Ed 581, 62 S Ct 399. . . ."

In this matter, Iowa Code Section 422.33 does not make compliance with both that section and federal law an impossibility and it does not stand as an obstacle to the accomplishment of the full purposes and objectives of Congress. Iowa Code Section 422.33 is not superseded by the OCSLA, it does not conflict with the OCSLA and is not in violation of the Supremacy Clause of the United States Constitution.

SECOND ISSUE

20. The second issue is set out in paragraph 44 of the *STIPULATION* of the parties and that issue reads as follows:

> 44. Whether the Department of Revenue was required to make its assessment for the years 1975, 1976, and 1977 of additional tax against Shell reflected by the June 10, 1982, assessment (Exhibit

> 10) when the assessment was not based upon federal audit adjustments to federal taxable income within three years after Shell filed its Iowa Income Tax Returns for the years 1975, 1976 and 1977.

21. That issue asks the question whether the Department is restricted to making assessments solely based upon federal audit adjustments to federal taxable income after the 3 years period set out in Iowa Code Section 422.25(1) has ended. The Protestor had been audited by the IRS for the years in question and had never notified the Department in writing of the final disposition of the IRS matter, therefore the six months limitation period set out in Iowa Code 422.25(1) has never begun and has not expired.

22. This hearing officer considered that same issue (Second issue) in In The Matter Of Kelly-Springfield Tire Co., Docket No. 81-49-2A-A (A Department contested case, Proposed Order issued April 4, 1984, currently on appeal to the Iowa State Board of Tax Review). That Proposed Order discussed this same issue and the following paragraphs 23 through 36 are taken from that Order.

> 23. At the evidentiary hearing, the question of whether the six-month limitation clause of Iowa Code § 422.25(1) (1979) gave the Department the authority to make the assessment in this case was argued by both parties. That question was further refined so that the issue became whether or not an assessment authorized by the six-month limitation clause in Iowa Code § 422.25(1) (1979) was restricted to adjustments made by the IRS in its audit or if the Department could make an assessment on matters not covered by the IRS adjustments.
>
> 24. The limitation period set out in Iowa Code § 422.70 is five years. The assessment in this matter was in December, 1980. Neither party argued or

presented evidence to show that the assessment was authorized under Iowa Code § 422.70. The Hearing Officer concludes that the allegation that Iowa Code § 422.70 would authorize the assessment in this matter was abandoned by the parties.

25. The six-month period for assessment after final disposition of a controversy between a taxpayer and the IRS was added to Iowa Code § 422.25(1) by amendment in Chapter 211 Iowa Acts 1957, p. 269. That amendment added the following language to Iowa Code § 422.25 (1954):

> Notwithstanding the periods of limitation for examination and determination heretofore specified, the commission shall have six (6) months from the date of final disposition of any controversy between the taxpayer and the Internal Revenue Service with respect to the particular tax year to make its examination and determination.

The title to that Chapter 211 reads " AN ACT . . ., Relating to Periods of Limitation and Other Administrative Provisions . . ."

26. The six-month limitation period clause in Iowa Code § 422.25(1) was amended by Chapter 244, Iowa Acts 1973, p. 505, as follows:

> Notwithstanding the periods of limitation for examination and determination heretofore specified, the department shall have six months [from the date of final disposition of any controversy between the taxpayer and the internal revenue service with respect to the particular tax year to make the examination and determination.] *to make an examination and determination from the date of receipt by the department of notice from the taxpayer of the final*

> *disposition of any matter between the taxpayer and the internal revenue service with respect to the particular tax year. In order to begin the running of the six-months period, the notice shall be in writing in any form sufficient to inform the department of such final disposition with respect to such year, and a copy of the federal document showing the final disposition or final federal adjustments shall be attached to the notice.*

The title of Chapter 244 is "AN ACT relating to state income tax audits." The parties disagree as to the exact wording of the explanation in Senate File 76 (Chapter 244, Iowa Acts 1973). That explanation reads as follows:

> This bill allows the Department of Revenue six months from receipt of the final disposition of any controversy between the taxpayer and the Internal Revenue Service to notify the taxpayer of any additional tax due. Under the present law where no such notification ([by] *to*) taxpayer ([to] *by*) the Department of Revenue is required, thousands of dollars of Iowa state income taxes found to be due because of Internal Revenue Service audits are lost because of the limitation periods. This bill will prevent such loss of revenue without increasing any taxes, by merely clarifying a statute of limitation technicality to prevent loss of taxes otherwise clearly due the state.

The two words disagreed upon by the parties are enclosed in parentheses in the above quote. The Hearing Officer concludes that the two disputed words do not make any material difference in this matter.

27. The six-month limitation period clause in Iowa Code § 422.25(1) was again amended by Chapter

1140 Iowa Acts 1978, p. 688. That amendment added the underlined words so that the six-month limitation period clause read as follows:

> Notwithstanding the periods of limitation for examination and determination heretofore specified, the department shall have six months to make an examination and determination from the date of receipt by the department of *written* notice from the taxpayer of the final disposition of any matter *which occurred after the expiration of the applicable period of limitation specified in this section* between the taxpayer and the internal revenue service with respect to the particular tax year. In order to begin the running of the six-months' period, the notice shall be in writing in any form sufficient to inform the department of such final disposition with respect to such year, and a copy of the federal document showing the final disposition or final federal adjustments shall be attached to the notice.

28. The six-month limitation period clause in Iowa Code § 422.25(1) was again amended in 1981. The phrase "examination and determination" was not changed by the 1981 amendment.

29. Does the phrase "examination and determination" limit the Department to consideration of adjustments made by the IRS or does it authorize a wider inquiry into Protestor's tax liability? The six-month limitation period clause begins with this language: "Notwithstanding the periods of limitation for examination and determination heretofore specified, . . ." That "heretofore specified" examination and determination is set out in the first sentence of Iowa Code § 422.25(1), and that sentence, in pertinent part, reads as follows: "As soon as practicable and in any event within three years after the return is filed the department shall examine it and determine the correct amount of tax, . . ." That provision obviously is not restricted to adjustments by the IRS. The terms "examine" or "examination" and "determine" or "determin-ation," both appearing in Iowa Code subsection 422.24(1), would refer to the same acts or process and would have the same scope. Since the terms, when used in connection with the three year limitation, are not limited to IRS adjustments, it would follow, strictly from a reading of the Code, that the terms, when used in connection with the six-month limitation clause, were not limited to IRS adjustments.

30. In determining the meaning and scope of statutory language, the Iowa Supreme Court has adopted the following rules which are appropriate in this matter. In *Hinders v. City of Ames*, 329 N.W.2d 654, 655 (Iowa 1983), the Iowa Supreme Court quoted the following rules of statutory construction:

> [1] The purpose of all rules of statutory construction is to ascertain the intent of the enacting legislature. *See e.g., State v. Whetstine*, 315 N.W.2d 758, 760 (Iowa 1982); *American Home Products v. Iowa State Bd. of Tax*, 302 N.W.2d 140, 142 (Iowa 1981). Where, however, the language of the statute is clear and plain there is no room for construction, *see, e.g., Iowa National Industrial Loan Co. v. Iowa State Dep. of Revenue*, 244 N.W.2d 437,440 (Iowa 1974), and the sole function of this court is to apply the statute according to its terms. *See, e.g., State v. Sharkey*, 331 N.W.2d 68, 72 (Iowa 1981); *State v. Baker*, 293 N.W.2d 568, 572 (Iowa 1980).

31. The Iowa Supreme Court in *State v. Vietor*, 208 N.W.2d 894, 898 (Iowa 1973) stated as follows:

> [6] In construing statutes, the court searches for the legislative intent as shown by what the legislature has said rather than what it should or might have said. McKillip v. Zimmerman, Iowa, 191 N.W.2d 706, 709; Shriver v. City of Jefferson, Iowa, 190 N.W.2d 838, 839.

32. It is the conclusion of the Hearing Officer that, if the General Assembly had so intended, it could have limited the examination to adjustments made by the IRS, but chose to use the same words ("examine" and "determine") in connection with both the three year and six month limitation clauses in Iowa Code § 422.25(1). This statutory wording is plain, unambiguous and consistent throughout Iowa Code § 422.25(1).

33. Judge Anthony M. Critelli, in the Polk County, Iowa District Court case of *Moorman Manufacturing Company v. G. D. Bair, Director of Revenue, State of Iowa*, in Equity No. CE3-15——, in an opinion issued December 17, 1976, found that:

> The duty of the department, to be accomplished "as soon as practicable and in any event within three years" from the filing of a corporate taxpayer's returns, is to "examine" the returns and "determine" the correct amount of tax. Section 422.25. Notwithstanding this general limitation, the department is given an addition six months which begins upon the resolution of a controversy existing between the taxpayer and Internal Revenue Service to "examine and determine" the taxpayer's Iowa returns in light of the final disposition made between the taxpayer and Internal Revenue Service. During either the first three year period or a second six months extension, the scope of the department's inquiry respecting the taxpayer's returns is the

> same—the department must "examine" and "determine."
>
> Webster's Seventh New Collegiate Dictionary 288-9 (1965) defines the verb "examine" to mean "to inspect closely; to test the condition of; to inquire into carefully . . . ." "Determine," as a verb, is defined to include the following actions: "to fix conclusively or authoritatively; to decide by judicial sentence; to settle or decide by choice of alternatives or possibilities; . . . to come to a decision . . . ." *Id.*, at 226.
>
> Because the legislature gave the department the same latitude in reviewing a taxpayer's returns after a federal audit had begun as the department had initially within the original three year examination period, the conclusion would seem inescapable that the department is not limited to a mere *recomputation* of the taxpayer's Iowa liability based upon newly developed federal figures (emphasis added). The department is accorded the authority, as they are in the first instance, to scrutinize and inspect the Iowa returns and decide and fix the amount of tax liability. Thus it is apparent that the department may challenge Moorman's apportionment formula and the tax liability following from its use in the period beyond the three year limitation as within its powers to both "examine and determine."
>
> More supportive still of this conclusion is a focus on another aspect of the six months statutory exception. Regarding the nature of the controversy existing between the taxpayer and Internal Revenue Service, Section 422.25 says ". . . the department shall have six months

from the date of final disposition of *any* controversy between the taxpayer and the internal revenue service. . . ." (emphasis added).

We cannot help but believe that the broad powers vested in the department to "examine and determine" anew after a federal audit had begun were powers then constrained to such duties only if the federal audit produced adjusted income which, in turn, might adjust Iowa taxable income. It is plain that the controversies between the taxpayer and Internal Revenue Service which can result in application of the department's statutory duties are not just certain controversies whose resolution changes the taxpayer's base for Iowa tax purposes but "any controversy" whether a change affecting Iowa tax results or does not result.

In *Moorman*, the federal audit made no difference in taxpayer's Iowa tax liability; the assessment was based on items not adjusted by the federal audit. The foregoing decision was appealed on other issues, but not on the issue discussed in this paragraph.

34. In the case of *American Home Products Corporation*, Docket No. 192, the Iowa State Board of Tax Review held that the Department could make an assessment under the six months clause of Iowa Code § 422.25(1) on items not adjusted by the federal audit. That decision was issued on June 2, 1979. The Board's decision on the foregoing issue was appealed to the Polk County District Court, Docket No. CE11-6178, and, in a decision filed February 20, 1980, Judge J. P. Denato upheld the Board's decision. The judge's decision on that issue was not appealed, though other issues were appealed.

35. Protestor cited cases from other states in support of its proposed interpretation of Iowa Code § 422.-

25(1). The Hearing Officer concludes that these cases are not persuasive because of the plain language of Iowa Code § 422.25(1) and because the cases from other states are based on different, though similar, statutes.

36. As previously discussed, it is the conclusion of the Hearing Officer that the plain language of Iowa Code § 422.25(1) grants the Department the authority to make the assessment in this case; that the State Board of Tax Review has upheld the Department's authority to make such an assessment; and that the Polk County District Court has upheld the Department's authority to make such assessments in two decisions.

37. The hearing officer concludes that the Department is not restricted to assessments based on federal audit adjustments based on the reasoning and citations in Kelly-Springfield, supra, paragraphs 22 through 36.

THIRD ISSUE

38. The third issue is set out in paragraph 45 of the *STIPULATION* of the parties and that issue reads as follows:

> 45. Whether, if Shell is entitled to exclude total OCS revenues from its pre-apportionment net income base as computed in Exhibit 7, pages 1-6, Shell is barred from claiming refunds for 1975-80 by reason of § 422.73 of the Iowa Code.

39. For the years 1975 through 1978, the following Iowa Code Section 422.73 was in effect:

> 422.73. Correction of errors. If it shall appear that, as a result of mistake, an amount of tax, penalty, or interest has been paid which was not due under the provisions of this chapter, then such amount shall be credited against any tax due, or to

become due, under this chapter from the person who made the erroneous payment, or such amount shall be refunded to such person by the department. No claim for refund or credit that has not been filed with the department within five years after the tax payment upon which a refund or after such tax payment was made, whichever time is the later, shall be allowed by the director. Notwithstanding the period of limitation specified, the taxpayer shall have six months from the day of final disposition of any income tax controversy between the taxpayer and the internal revenue service with respect to the particular tax year or years to claim an income tax refund or credit, provided the taxpayer has notified the department of revenue of the existence of said income tax controversy within the five-year limitation period.

40. For the years 1979 and 1980, the following Iowa Code Section 422.73, as amended by 1978 Iowa Acts Chapter 1140, applied to corporate income tax and that section read, in pertinent part, as follows:

> 2. If it shall appear that, as a result of mistake, an amount of tax, penalty, or interest has been paid which was not due under the provisions of divisions II, III or V of this chapter, then such amount shall be credited against any tax due, or to become due, under this chapter from the person who made the erroneous payment, or such amount shall be refunded to such person by the department. A claim for refund or credit that has not been filed with the department within three years after the return upon which a refund or credit claimed became due, or within one year after the payment of the tax upon which a refund or credit is claimed was made, whichever time is the later, shall not be allowed by the director; . . .
>
> . . . Notwithstanding the period of limitation specified, the taxpayer shall have six months from the day of final disposition of any income tax matter between

> the taxpayer and the internal revenue service with respect to the particular tax year or years to claim an income tax refund or credit, provided the taxpayer has notified the department of revenue in writing no later than six months after the expiration of the three-year limitations period of the existence of such income tax matter.

41. For the years 1975 through 1978, Iowa Code Section 422.73 states that the Director "shall" not grant a refund unless the claim is timely filed (within 5 years). For 1979 and 1980, the Director "shall" not grant a refund unless the claim is timely filed (within 3 years). No refund claim was filed by Protestor for the years 1975 through 1980.

42. Protestor contends that Iowa Code Section 422.73 does not preclude the granting of a refund in cases where the Department commenced an audit and determined that taxpayer had overpaid the tax. Protestor cites Iowa Code Section 422.25(1), Iowa Code Section 422.28 and a State Board of Tax Review opinion in the case of *Iowa Manufacturing Company of Cedar Rapids v. Iowa Department of Revenue* (opinion dated July 31, 1968) in support of that contention.

43. Iowa code Subsection 422.25(3) provides that "If the amount of the tax as determined by the department" is less than the amount paid, the excess shall be refunded. That provision applies to Department audits. In this matter, the Department did not "determine", by audit, that Protestor had overpaid tax because of OCS revenues. On this third issue, Protestor is attempting to obtain a refund on grounds not previously considered by either audit or refund claim. Iowa Code Section 422.25(3) does not require or authorize the granting of such a refund.

44. Iowa Code Section 422.28 reads, in pertinent part, as follows:

"A taxpayer may appeal to the director for revision of the tax, interest or penalties assessed at any time within ninety days from the date of the notice of the assessment of tax, additional tax, interest or penalties. The director shall grant a hearing and if, upon the hearing, the director determines that the tax, interest or penalties are excessive or incorrect, the director shall revise them according to the law and the facts and adjust the computation of the tax, interest or penalties accordingly. The director shall notify the taxpayer by registered mail of the result of the hearing and shall refund to the taxpayer the amount, if any, paid in excess of the tax, interest or penalties found by the director to be due, with interest after sixty days from the date of payment by the taxpayer at the rate in effect under section 421.7 for each month or a fraction of a month. . . ."

45. Iowa Code Section 422.28 provides for an appeal "for revision of the tax, interest or penalties assessed. . . ." What was "assessed"? That section goes on to state that the appeal must be within 90 days from "the date of the notice of the assessment of tax, additional tax, interest or penalties." The tax, interest and penalty "assessed" is the assessment set out on the notice of assessment. The subject of the appeal and the hearing would be the assessments appearing on the notice of assessment and not refund claims, first presented in the protest, based on facts, items or theory different from the basis for the assessment of taxes, interest or penalty assessed in the Notice of Assessment. Protestor cannot present a refund claim in its protest based on grounds or items which were not the basis for the assessment.

46. In *Iowa Manufacturing Company*, supra, the Department discovered the overpayment of taxes on audit, but disagreed on the granting of the refund because of Iowa Code Section 422.66 (now 422.73). In this case,

Protestor seeks to present a totally unrelated refund claim, not timely presented as a refund claim under Iowa Code Section 422.73(2), during an appeal for revision of the assessment set out on the notice of assessment. Because of the factual difference, *Iowa Manufacturing*, supra, does not apply. Protestor cannot obtain a refund in this matter on the basis of the third issue facts or law.

SUMMARY

47. The issues in this matter were stipulated by the parties (See paragraphs 43, 44 and 45 of the Stipulation and Findings of Fact). Other issues and peripheral issues argued in the Briefs were not properly or timely raised and are not considered in this Proposed Order. This Proposed Order is confined strictly to the issues set out in the Stipulation.

48. As stated in preceding paragraphs 19, 37 and 46 of these Conclusions of Law, the Protestor has failed to prove that the assessment was in error. The Department properly and legally assessed the tax, interest and fees for corporation income tax as the assessment is set out on a Notice of Assessment bearing notice date of June 10, 1982. It is the conclusion of the hearing officer, based on the whole record, that the evidence in this matter is more than substantial to support the factual and legal conclusions reached by the hearing officer in this Proposed Order.

49. An Order For Deletion was entered in this matter on December 14, 1984, deleting exhibits 1 through 10 and exhibits G through L from the protest file prior to disclosure to members of the public.

50. A First Supplement To Deletion Order was issued by the hearing officer on July 23, 1985. That deletion order was restricted to deletions from documents in existence at the time of the order, with the deletions specifi-

cally set out on copies of the documents from which deletions were made. These deletions are as follows:

BRIEF OF PROTESTOR

Page 3—amounts deleted from chart

Page 8—second paragraph

Page 9—second sentence

Page 12—second paragraph, second and fourth sentence

Page 14—amounts deleted from chart

Page 17—amounts deleted from chart

Page 49—second paragraph of (b)

Page 50—first paragraph amounts deleted from chart

Page 63—amounts deleted from chart

Page 64—amounts deleted from chart

REPLY BRIEF OF PROTESTOR

Page 10—amounts deleted from chart

Page 15—amounts deleted from chart

Page 21—paragraph 1 of V

Page 22—first paragraph, fourth sentence

Page 23—end of first full paragraph

Page 24—paragraph (c)

Page 25—first paragraph, first sentence

Page 26—first sentence

BRIEF OF DEPARTMENT OF REVENUE

Page 6—third paragraph, first sentence

Page 14—second paragraph

Page 15—footnote 2

Page 19—second, third, fourth sentences
Footnote 4

Page 20—last two sentences on page

Page 32—first paragraph, fifth sentence

Page 35—first sentence

51. Pursuant to Iowa Code § 17A.15(3), this Proposed Order becomes the final order of the Iowa Department of Revenue without further proceedings unless there is an appeal to, or review on motion of, the Department within 30 days of the issuance of this Proposed Order.

Issued at Des Moines, Iowa, this 26th day of August, 1985.

IOWA DEPARTMENT OF REVENUE

By Orville Caruthers
Orville Caruthers
Hearing Officer

APPENDIX E

IN THE SUPREME COURT OF IOWA

Supreme Court No. 86-1565

SHELL OIL COMPANY,
Petitioner-Appellant,

vs.

THE IOWA DEPARTMENT OF REVENUE,
Respondent-Appellee.

[Filed Nov. 23, 1987]

NOTICE OF APPEAL TO THE UNITED STATES SUPREME COURT

NOTICE IS HEREBY GIVEN that Shell Oil Company appeals to the United States Supreme Court, pursuant to 28 U.S.C. § 1257(2), from the judgment of the Iowa Supreme Court set forth in Part II, beginning on page 10, of the opinion of this Court in these proceedings, filed October 21, 1987, entitled "Claims Involving Taxation of Revenues Derived From Outer Continental Shelf Lands", and all rulings and judgments inherent therein.

Dated this 19th day of November, 1987.

/s/ James W. Hall
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APPENDIX F

STATUTORY PROVISIONS INVOLVED

Section 4(a) of the Outer Continental Shelf Lands Act, 43 U.S.C. § 1333(a), provides (emphasis added):

> (1) The Constitution and laws and civil and political jurisdiction of the United States are extended to the subsoil and seabed of the outer Continental Shelf and to all artificial islands, and all installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exp[l]oring for, developing, or producing resources therefrom, or any such installation or other device (other than a ship or vessel) for the purpose of transporting such resources, to the same extent as if the outer Continental Shelf were *an area of exclusive Federal jurisdiction* located within a State: *Provided, however,* That mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of this subchapter.
>
> (2)(A) To the extent that they are applicable and not inconsistent with this subchapter or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State, now in effect or hereafter adopted, amended, or repealed are declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines extending seaward and defining each such area. All of such applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. *State taxation laws shall not apply to the outer Continental Shelf.*

> (B) Within one year after September 18, 1978, the President shall establish procedures for sett[l]ing any outstanding international boundary dispute respecting the outer Continental Shelf.
>
> (3) The provisions of this section for adoption of State law as the law of the United States *shall never be interpreted as a basis for claiming any interest in* or jurisdiction on behalf of any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or *the property and natural resources thereof or the revenues therefrom.*

23 Iowa Code Ann. §§ 422.32, 422.33, 422.35 provide in pertinent part:

§ 422.32. Definitions

For the purpose of this division and unless otherwise required by the context:

* * * *

5. The term "unitary business" means a business carried on partly within and partly without a state where the portion of the business carried on within the state depends on or contributes to the business outside the state.

* * * *

10. "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

§ 422.33. Corporate tax imposed—credit

* * * *

2. If the trade or business of the corporation is carried on entirely within the state, the tax shall be im-

posed on the entire net income, but if the trade or business is carried on partly within and partly without the state, the tax shall be imposed only on the portion of the net income reasonably attributable to the trade or business within the state, with the net income attributable to the state to be determined as follows:

* * * *

(4) Where income is derived from the manufacture or sale of tangible personal property, the part attributable to business within the state shall be in that proportion which the gross sales made within the state bear to the total gross sales.

§ 422.35. Net income of corporation—how computed

The term "net income" means the taxable income before the net operating loss deduction, as properly computed for federal income tax purposes under the Internal Revenue Code of 1954, with the following adjustments * * *.

APPENDIX G

STATEMENT PURSUANT TO RULE 28.1

SHELL OIL COMPANY *

A. *Shell Oil Company*

Subsidiary Companies

IND/AG Chemicals, Inc.
Pecten Arabian Company
Pecten Cameroon LNG Limited
Pecten Chemicals Inc.
Pecten Export Corporation
Pecten Middle East Services Company
Pecten Trading Company
Pecten Ventures Limited
Pecten Vietnam Company
SES, Incorporated
Shell Agricultural Chemical Company
Shell Capital, Inc.
Shell Communications, Inc.
Scallop Corporation
Shell Credit, Inc.
Shell Energy Resources Inc.

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* Shell Oil Company's parent corporation is SPNV Holdings, Inc., which, in turn, is owned by Shell Petroleum N.V. The latter's parents are Royal Dutch Petroleum Company (a Netherlands corporation) and The "Shell" Transport and Trading Company, p.l.c. (a United Kingdom corporation). Shell Oil Company itself owns directly or indirectly, both 100% and less than 100% stock interests in approximately 120 corporations that operate both in the United States and in foreign countries. All of the companies are often referred to collectively as the "Royal Dutch/Shell Group of Companies." Counsel is advised that there are subsidiaries, not wholly owned, and affiliates throughout the world of this group which, in the aggregate, are so numerous that they could not be determined or identified for the Court within the time frame for filing this Jurisdictional Statement.

Shell Export Company
Shell Investment, Inc.
Shell Motorist Club, Inc.
Shell Pipe Line Corporation
Shell Polymers and Catalysts Enterprises Inc.
Triton Biosciences Inc.
Western Farm Services, Inc.

Affiliated Companies

Fractionation Research, Inc.
Gravcap, Inc.
Heat Transfer Research, Inc.
Inland Corporation
Loop, Inc.
Lucky Chance Mining Company, Inc.
Mesbic Financial Corporation of Houston
Oil Companies Institute for Marine Pollution Compensation Limited
Oil Insurance Limited
Seadock, Inc.

B. *Shell Credit, Inc.*

Subsidiary Companies

Shell Finance Company
Shell Leasing Company

C. *Shell Energy Resources Inc.*

Subsidiary Companies

Pecten International Company
Shell Gas Pipeline Company
Shell Gas Trading Company
Shell Mining Company
Shell Offshore Inc.
Shell Western E&P Inc.
Scallop Coal Company

D. *Pecten International Company*

Subsidiary Companies

Pecten Argentina Company
Pecten Ash Sham Company
Pecten Bahamas Company
Pecten Belize Company
Pecten Brazil Alagoas Company
Pecten Brazil Alagoas Petroleum Company
Pecten Brazil Amazon Company
Pecten Brazil Amazon Exploration Company
Pecten Brazil Amazon Exploration and Development Company
Pecten Brazil Amazon Petroleum Company
Pecten Brazil Bahia Company
Pecten Brazil Bahia Exploration Company
Pecten Brazil Bahia Exploration and Development Company
Pecten Brazil Bahia Petroleum Company
Pecten Brazil Exploration Company
Pecten Brazil Maranhao Company
Pecten Brazil Maranhao Exploration Company
Pecten Brazil Petroleum Company
Pecten Brazil Rio Grande Do Norte Company
Pecten Cameroon Company
Pecten Canada Limited
Pecten Ecuador Company
Pecten Guinea-Bissau Company
Pecten Malaysia Company
Pecten Malaysia Petroleum Company
Pecten Orient Company
Pecten Overseas Petroleum Company
Pecten Paraguay Company
Pecten Portugal Company S.A.R.L.
Pecten Potiguar Company
Pecten Santos Company
Pecten Santos Exploration Company
Pecten Santos Petroleum Company

Pecten Sarawak Company
Pecten Syria Company
Pecten Syria Petroleum Company
Pecten Tanzania Company
Pecten Tunisia Company
Pecten Victoria Company
Taranaki Offshore Petroleum Company

E. *Shell Mining Company*

Subsidiary Companies

Bellaire Trucking Company
Pecten Coal International Inc.
R. & F. Coal Company
Triton Coal Company
Turris Coal Company
Billiton Metals Inc.
Billiton Minerals U.S.A. Inc.

F. *Shell Offshore Inc.*

Subsidiary Companies

Burrwood Gathering Company
SOI Royalties Inc.

G. *Shell Western E&P Inc.*

Subsidiary Companies

Belridge Farms
Belridge Packing Co.
Chaparro Gathering Company
Choctaw Pipe Line Company
Swepi Royalties Inc.
Shell California Offshore Pipeline Inc.
Shell Cortez Pipeline Company
Shell Western Pipelines Inc.
East Texas Salt Water Disposal Company

Grande Ecallie Land Company, Inc.
Thums Long Beach Company
Van Salt Water Disposal Company
WIDC (Wyoming Industrial Development Corporation)

H. *Shell Cortez Pipeline Company*

Affiliated Company

Cortez Capital Corporation

I. *Pecten Arabian Company*

Subsidiary Company

Pico Limited

J. *Taranaki Offshore Petroleum Company*

Subsidiary Company

Taranaki Offshore Petroleum Company Limited

K. *Shell Chemical Company*
(a division of Shell Oil Company)

Affiliated Companies

George Newman & Company
United Scientific, Inc.

L. *Pecten Trading Company*

Affiliated Company

Oil Companies Institute for Marine Pollution Compensation Limited

M. *Western Farm Service, Inc.*

Subsidiary Company

Pioneer Equipment Co.

N. *Shell Pipe Line Corporation*

Subsidiary Companies

Butte Pipe Line Company
San Joaquin Valley Pipe Line Company

Affiliated Companies

Dixie Pipeline Company
Explorer Pipeline Company
Locap, Inc.
Olympic Pipe Line Company
Plantation Pipe Line Company
West Shore Pipe Line Company
Wolverine Pipe Line Company

O. *Shell Polymers and Catalysts Enterprises Inc.*

Subsidiary Companies

Ardyne Inc.
CRI Ventures, Inc.
Morrison Molded Fiber Glass Company
Premix/EMS Inc.
Quazite Corporation
Rampart Packaging Inc.
Xerkon Inc.

P. *Morrison Molded Fiber Glass Company*

Subsidiary Companies

AFC, Inc.
Glastrusions, Inc.
Glass-Steel, Inc.

Q. *Scallop Coal Company*

Subsidiary Companies

Justin Coal Corporation
Marrowbone Development Company
Wolf Creek Collieries Company
Massey Coal Terminal Corporation

R. *Billiton Metals Inc.*

Subsidiary Companies

Billiton Commodies Inc.

S. *Scallop Corporation*

Subsidiary Companies

AP Shipping Corporation
Argus Realty Services Inc.
Asiatic Petroleum Corporation
Greater New York Terminal, Inc.
Houston Fuel Oil Terminal, Inc.
Nickerson American Plant Breeders Inc.
Royal Lubricants Company, Inc.
Scallop Liquified Natural Gas, Inc.

T. *Marrowbone Development Company*

Subsidiary Companies

Big Beaver Coal Company

U. *Massey Coal Terminal Corporation*

Subsidiary Companies

Clipper Coal Corporation
Comcoal Corporation
East Kentucky Energy Corporation
Kermit Coal Company
Pike County Coal Corporation
Redbone Coal Company, Inc.
Massey Coal Terminal S. C. Corporation
SLT Corporation
Sunset Coal Corporation
Tug River Mining Group, Inc.

V. *Massey Coal Terminal S. C. Corporation*

Subsidiary Companies

Cooper River Coal Terminal Company